National Money Laundering and Terrorist Financing Risk Assessment Process

Information Sharing Roundtable Discussion:
Assessing Money Laundering and Terrorist Financing Risks

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New FATF Recommendation 1

Assessing Risks

- Countries are required to identify, assess, and understand their ML/TF risks

- Financial institutions and DNFBPs are required to identify, assess, and understand their ML/TF risks

- FATF has published guidance on National ML/TF risk assessment

Effectiveness assessment (Immediate Outcome 1)

"Money laundering and terrorist financing risks are understood, and where appropriate, actions coordinate domestically to combat money laundering and the financing of terrorism and proliferation"

1. How well does the country understand its ML/TF risks?
2. How well are the identified ML/TF risks addressed by national AML/CFT policies and activities?
3. To what extent are the results of the assessment(s) of risks properly used to justify exemptions and support the application of enhanced measures for higher risk scenarios, or simplified measures for lower risk scenarios?
4. To what extent are the objectives and activities of the competent authorities and self-regulatory bodies consistent with the evolving national AML/CFT policies and with the ML/FT risks identified?
5. To what extent does the country ensure that respective financial institutions, DNFBPs, and other sectors affected by the application of the FATF standard are aware of the relevant results of the national ML/TF risk assessment?

Why it is important to assess the risk

- Assessing risks is the basis of any effective risk-based AML/CFT regime, tailored and adapted to the specific national risk contexts. It helps to:
  - Identify effective risk mitigation strategies
  - Design appropriate and proportionate policy responses, and prioritize risk mitigation activities, commensurate to the level of the identified risk
  - Make and justify decisions about limiting AML/CFT coverage of financial institutions and products on the basis of "low risk" (financial inclusion)
  - Improve AML/CFT regimes (e.g., by supplementing FATF standards with additional measures to deal with identified risks)

How to assess risk?

- Risk can be seen as a function of three factors: **threat, vulnerability,** and **consequence**. An ML/TF *risk assessment* is a product or process based on a methodology, agreed by those parties involved, that attempts to identify, analyse, and understand ML/TF risks and serves as a first step in addressing them" (FATF Guidance on NRA)

- **No universally accepted methodology**

- **IMF, World Bank, OSCE**

- Countries assessed under the new FATF standard so far: Australia, Belgium, Norway, Spain, Italy: in-house developed methodologies

Threat

- **ML threat can be:**
  - Criminals, past, present, and future ML activities
  - Domestic proceeds of crime (i.e., all illegal revenue) from crimes committed domestically
  - Transnational (international) inflows of proceeds of crime from crimes committed abroad

- **FT threat can be:**
  - Terrorist groups/Terrorists, past, present and future terrorist and TF activities
  - Domestic funds raised from legally or illegally obtained assets
  - Transnational (international) inflows of funds from sources abroad

Vulnerability

- **ML/FT vulnerability** relates to the intrinsic properties in a product, service, distribution channel, customer base, institution, system, or jurisdiction (including weaknesses in systems, controls, or measures) that enable ML or FT risk events

- **Three main categories that have an impact on vulnerabilities**
  - Intrinsic properties: Not altered much by controls (e.g., geography, size of economy, currency, general aspects of products and services)
  - General controls and mitigants: Non-AML/CFT controls (e.g., non-AML supervision, tax scrutiny, registers, transparency of legal persons etc.)
  - AML/CFT controls: CDD/KYC, reporting requirements, etc

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Consequences

- **Consequence** refers to the impact or harm that ML or TF may cause and includes the effect of the underlying criminal and terrorist activity on financial systems and institutions, as well as the economy and society more generally

- **Two types of ML/FT consequences**
  - Short-term consequences
    - Volume of ML/FT-related transactions occurring, directly or indirectly, through different categories of firms

  - Long-term consequences of risk events
    - Political (i.e. criminal organizations threaten or subvert state power)
    - Economic (i.e. macroeconomic impact of the drug economy)
    - Social (i.e. the increased costs of more crime)

The preliminary process

- A national ML/TF risk assessment can be composed of different types of assessments, and the different levels could be combined together to form a national-level understanding of the risk with each limited-scope assessment contributing to the overall picture (Spain).

- Before conducting an ML/TF risk assessment, it is essential that there be the political will to carry out this work and ensure that the objectives of the assessment can be achieved.

- In establishing an ML/TF risk assessment process, some countries may choose to establish a more formal inter-agency working group or the like to oversee their risk assessment process. Ideally there should be a clear determination and designation of the specific agency, organization or "task force" in charge of leading and coordinating the process.

Areas that should be covered by the NRA

- Threat assessment

- National vulnerability

- Terrorist financing (proliferation of weapons of mass destruction and its financing: optional, not required by the standard)

- Banking sector

- Securities sector

- Insurance sector

- Other financial institutions (e.g. money exchange, money remitters)

- Designated non-financial businesses and professions (DNFBPs) and other sectors

- Other areas

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Who should be involved in the NRA?

- It is advisable that a national-level ML/TF assessment exercise involve a broad range of relevant departments, agencies and other organizations within the government:
  - Policy makers
  - Prosecution and Law enforcement
  - Financial Intelligence Units
  - Intelligence agencies
  - Regulatory and supervisory bodies

Source: FATF Guidance on NRA

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But also the Private Sector…

- As noted by the FATF, private sector involvement may also be valuable in building a complete picture of national ML/TF risks and may benefit the assessment process in a number of ways: source of information and end user.

- Direct or indirect involvement?

  – Consider that sometimes the private sector may have commercial interests that might preclude a completely impartial view of ML/TF risk.

- The private sector could be primarily involved through surveys, questionnaires, and interviews. Representatives of the private sectors (for example industry associations, like the bankers association) could be invited at various stages of the NRA process to seek their input, on an ad hoc and as needed basis

How to do it? Quantitative Data (Mapping and Collecting Information and Statistics)

- General information about the country and its economy

- Proceeds of crime

- Terrorism and Terrorist Financing

- Cross border transportation of currency

- Mutual legal assistance

- Composition of private sector

- STRs

- Financial and DNFBP supervision

- ETC….

How to do it? Qualitative Data: Solicit Expert Views

- Surveys and Questionnaires

- Group Workshop Session Exercises

- Structured Interviews

A very common approach in risk analysis due to limited data and/or resources

Analysis of Threat

- Country level
  - Composition and magnitude of proceeds of crime (internal and external)
  - Incidents of terrorism – Presence of terrorist organizations (including foreign terrorist organizations that may pose a threat to the country)
  - Terrorist financing flows (raised and made available to domestic terrorist groups or organizations – raised in the country and made available for foreign terrorism)

- Sectoral Level
  - Specific ML/TF typologies in certain sectors

Analysis of Vulnerability

- Country level – sectorial level (specific analysis of products and services)

- Gross vulnerability/Net vulnerability (after existing mitigating factors including AML/CFT controls)

- Identification of the net risk

Analysis of Vulnerability

- Factors that increase the risk:
  - At country level (e.g. geographic position; currency; capacity of the institutional system, integrity of public authorities)
  - At sectorial level (based on the analysis of the characteristics of specific products and services and specific risk mitigating factors)

Analysis of Vulnerability

- Risk mitigating factors (examples):
    - Comprehensiveness of the AML/CFT system and compliance with the FATF standard (country level)
    - Effective implementation (country and sectorial level)
    - Existence of specific controls (sectorial level)

Analysis of Sector Vulnerability

- Each sector as a whole (Banks, Insurance, Securities, other types of financial institutions, lawyers, etc)

- Specific products and services (e.g. current accounts, life insurance products, bonds and equities, services offered by a lawyer, etc)

What information/data? (examples for sector)

- Are there ML/TF incidents reported in the sector
- Composition of the sector
- GDP % of the sector
- STR %
- Comprehensiveness of AML/CFT legal framework
- Effectiveness of regulation/supervision (for each of the financial sectors)
- Effectiveness of compliance function
- Other general factors that may affect the vulnerability of the sector (e.g. transparency of legal persons)

Specific Products and Services: what information/data (examples)

- Identify specific products and services for each sector (banks, insurance, securities, other financial institutions)
- Determine, for each identified product, net risk, having looked at factors like:
  - Level of cash associated to the product and service
  - Features that may favor anonymity in the use of the product
  - Type of clients to which the product/service is offered (high, medium, or low risk type of clients?)
  - Existence of specific requirements to mitigate the risks associated with certain types or clients/products/services (example: enhanced customer due diligence or enhanced reporting of transactions)
  - Existence of specific forms of AML/CFT control

Consequence

- The analysis of the consequences should be informed by the findings of the analysis of threat and vulnerabilities. The basic question is: what would be the consequence if ML/TF occurring in an inherent-high risk sector (net risk) were not effectively reduced by mitigating actions?
  - For example: if the banking sector were to be identified as posing the high risk, the consequence of ML/TF could be difficulties in financial institutions in accessing international financial markets, destabilization of the exchange rate etc

And at the end of the process?

- The NRA is not the end of the process, is the beginning…

- Prioritized action plan commensurate to the identified risks

- Authorities will have to consider how broadly the results of the risk assessment are to be disseminated amongst the various stakeholders. More specifically, Recommendation 1 requires countries to have mechanisms to provide appropriate information on the results of the risk assessments to all relevant competent authorities and self-regulatory bodies (SRBs), financial institutions and DNFBPs. (source: FATF Guidance on NRA)

Q&A and Thanks

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