THE NATURE OF AML/CFT RISK ASSESSMENTS

(Business & Customer)

CFATF

GAFIC

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Private Sector Risk Assessments

1. Developing a AML/CFT risk methodology
2. Applying Risk Findings
3. Customer Due Diligence (Perspective Of The Financial Institutions)

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Private Sector Risk Assessments

Basis for and Advantages of RBA
Types of risk assessments
Business line risk assessment
Components of a risk methodology
How to conduct a risk assessment
What types of customers pose a risk?
Types of behaviours suggesting risk
Possible risk factors
Risk scoring process

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<table>
<thead>
<tr>
<th>Rules-based Approached</th>
<th>Risk-based approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>• One size fits all</td>
<td>• AML measures commensurate with identified risk</td>
</tr>
<tr>
<td>• Potentially expensive</td>
<td>• Reduce cost of AML</td>
</tr>
<tr>
<td>• Regulatory compliance *Rec. 5</td>
<td>• Reflects national risks</td>
</tr>
<tr>
<td></td>
<td>• More focused</td>
</tr>
<tr>
<td></td>
<td>• Regulatory compliance *Rec. 10</td>
</tr>
</tbody>
</table>

*Rec. 5: Regulatory Compliance

*Rec. 10: Regulatory Compliance
What is risk?

Threats → Vulnerabilities → Consequences → RISKS
Private Sector Risk Assessments

Lack of awareness
Failure to identify money laundering transactions
Focus on fraud
Savings and investments features
Cash deposits/transactions
Use of intermediaries

VULNERABILITIES
The Risk Assessment

The risk of exposure of a financial institution affect and expose the entire business. Therefore a global risk assessment is conducted in order to understand the businesses’ entire risk exposure.

Risk will vary from time to time (Inherent vs residual)
The Risk Assessment

Enterprise-wide
- All business lines
- All subsidiaries
- All affiliates
- All holdings

Business line
- Specific business lines
- Products/services
- Customer base
- Geography
- Controls

Customer
- Customer base

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What? IS A RISK ASSESSMENT
The Risk Assessment

Measures:

• The inherent risk in a business and/or of process
• The strength of current controls
• The residual risk of a business and/or processes
Types

- Business Line Risk Assessment
- Customer Risk Assessment
Business Line Risk Assessment

Identifies Vulnerabilities

By evaluating

Controls &

- Inherent risks of products/services
- Customer base
- Geography

...at macro level
Customer Risk Assessment

Identifies Vulnerabilities

- Customer

By evaluating

Typically at the inception of each client relationship based on information provided during account opening process.
The Risk Assessment

How to conduct a risk assessment

Consider

• Types of customer
• Where you and your customers are based
• Customers' behaviour
• How customers come to you
• The products or the services offered
• Delivery channels and payment processes, (cash over the counter, cheques, electronic transfers or wire transfers)
• Where customers' funds come from or go to
Types of behaviours suggesting risk

• Not wanting to provide documentation, or providing documentation that isn't satisfactory
• Not wanting to reveal the name of a person they represent
• Agreeing to bear very high or uncommercial penalties or charges
• Entering into transactions that don't make commercial sense
• Transactions where you can't easily check where funds have come from
What types of customers pose a risk?

- New customers carrying out large, one-off transactions
- Introduced customers – (because the introducer may not have carried out due diligence thoroughly)
- Customers who aren't local to you
- Customers involved in a business that handles large amounts of cash
- Businesses with a complicated ownership structure that could conceal underlying beneficiaries
- Customer - or group of customers - who makes regular transactions with the same individual or group of individuals
The Risk Assessment

- Penetrates the past, present and future of activities
- Must be continuous
- As risk changes internal controls must be adjusted to meet compliance objectives
Evaluation is dependent on two phases

i. IDENTIFICATION

Identifies specific variables of business within the following categories:

- Clients
- Financial Products and Services
- Distribution Channels
- Jurisdictions or Geographic Areas

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The Risk Assessment

Evaluation is dependent on two phases

i. IDENTIFICATION

1. What factors affect a client’s risk rating for ML/TF?
2. What factors affect a financial product/service risk rating for ML/TF?
3. What factors affect makes a distribution channel susceptible to ML?
4. What factors affect a jurisdiction or geographic area’s risk rating for ML/TF?
Evaluation is dependent on two phases

ii. **ANALYSIS**

Analyses specific variable within the risk factors including:

- Number/quantity and volume of transaction
- Nature of customer relationship
- Purpose of the account
The Risk Assessment

Analysis has two specific objective

1. Determine risk tolerance/appetite; and

2. Identify residual risk

Determined by BoD

Feeds into AML/CFT Policy & Procedures

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Analyses must also include:

- Evaluation of the quality and effectiveness of AML/CFT Policies and Procedures
  - Training
  - Staffing
  - Resources
Risks are fluid and the assessment must be updated in order to identify changes in the financial institution’s profile.

Triggers for a risk update include:

• Changes in line of business
• Introduction of new products/services
• Growth through mergers & acquisitions
• Entry into new markets
• Results of NRA
Then What?
Audit Reviews the risk assessment and sufficiency of internal controls. Also reviews the efficiency of the internal controls via a risk-based audit.
The Risk Assessment

Factors to consider

1. Customer tenure
2. Product type
3. Geographic Locations – Country of Residence
4. Geographic Locations – Funds transfers
5. Geographic Locations – Crime or STR Hotspot
6. Economic Activity/High risk business
7. Transaction volume
8. Transaction volume (number of services requested)
9. Source of funds
10. Politically Exposed Person
11. Means of Payment
12. Private Investment Companies (PICs) /Asset Holding Vehicle
13. Suspicion of Money Laundering or Terrorist Financing

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The Risk Assessment

Factors to consider

1. Customer tenure
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6. Economic Activity/High risk business
7. Transaction volume
8. Transaction volume (number of services requested)
9. Source of funds
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11. Means of Payment
12. Whether or not Payment will be made to a Third Party
13. Private Investment Companies (PICs) / Asset Holding Vehicle
14. Suspicion of Money Laundering or Terrorist Financing

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The Risk Assessment

Factors to consider

Risk Quantification Matrix

## The Risk Assessment

### Quantification

<table>
<thead>
<tr>
<th>Customer Tenure</th>
<th>Risk Factor</th>
<th>Rating</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Client</td>
<td>H</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Less than 2 years</td>
<td>M</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>More than 2 years</td>
<td>L</td>
<td>1</td>
<td></td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>Account Type</th>
<th>Risk Factor</th>
<th>Rating</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>DDA</td>
<td>H</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Savings</td>
<td>L</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Trust</td>
<td>H</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Investment Account</td>
<td>H</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Loan</td>
<td>L</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Credit Card</td>
<td>M</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Any combination with a DDA</td>
<td>H</td>
<td>3</td>
<td></td>
</tr>
</tbody>
</table>
# The Risk Assessment

## Quantification

### Geographic Location (Country of Residence)

<table>
<thead>
<tr>
<th>Risk Factor</th>
<th>Rating</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>The residence is in a country considered high risk</td>
<td>H</td>
<td>3</td>
</tr>
<tr>
<td>The residence is in a country considered <strong>NOT</strong> high risk</td>
<td>L</td>
<td>0</td>
</tr>
</tbody>
</table>
### The Risk Assessment

#### Geographic Location (Funds transfer)

<table>
<thead>
<tr>
<th>Risk Factor</th>
<th>Rating</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>The country where customer sends/receives funds is considered high risk</td>
<td>H</td>
<td>3</td>
</tr>
<tr>
<td>The country where customer sends/receives funds is <strong>NOT</strong> considered high risk</td>
<td>L</td>
<td>0</td>
</tr>
</tbody>
</table>
The Risk Assessment → Quantification

| Geographic Location (Residence of high crime area) |
|-----------------------------------|--------|--------|
| Risk Factor | Rating | Score |
| The area where the customer resides is considered high risk | H | 3 |
| The area where the customer resides is **NOT** considered high risk | L | 0 |
# Economic Activity

<table>
<thead>
<tr>
<th>Risk Factor</th>
<th>Rating</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic activity or business of the customer is considered high risk</td>
<td>H</td>
<td>3</td>
</tr>
<tr>
<td>Economic activity or business of the customer is <strong>NOT</strong> considered high risk</td>
<td>L</td>
<td>0</td>
</tr>
</tbody>
</table>
### The Risk Assessment — Quantification

#### Transaction Volume (Size of transaction)

<table>
<thead>
<tr>
<th>Risk Factor</th>
<th>Rating</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer’s transaction profile for dollar amount is greater than <strong>&lt;Legislative SOFD trigger&gt;</strong></td>
<td>H</td>
<td>3</td>
</tr>
<tr>
<td>Customer’s transaction profile for dollar amount is greater than <strong>&lt;FI’s SOFD trigger&gt;</strong> but less than <strong>&lt;Legislative SOFD trigger&gt;</strong></td>
<td>M</td>
<td>2</td>
</tr>
<tr>
<td>Customer’s transaction profile for dollar amount is less than <strong>&lt;FI’s SOFD trigger&gt;</strong></td>
<td>L</td>
<td>0</td>
</tr>
</tbody>
</table>

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The Risk Assessment

### Transaction Volume (number of services requested)

<table>
<thead>
<tr>
<th>Risk Factor</th>
<th>Rating</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer exceeds 5 transactions per month in cash/manager’s cheques/wire transfers</td>
<td>H</td>
<td>3</td>
</tr>
<tr>
<td>Customer does <strong>NOT</strong> exceed 5 transactions per month in cash/manager’s cheques/international funds transfers</td>
<td>L</td>
<td>0</td>
</tr>
</tbody>
</table>

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### The Risk Assessment ➔ Quantification

#### *Source of Funds*

<table>
<thead>
<tr>
<th>Risk Factor</th>
<th>Rating</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer funds transfer activity does not include high risk international jurisdictions, HIDTAs, HIFCAs or other areas classified by the bank as high risk</td>
<td>L</td>
<td>0</td>
</tr>
<tr>
<td>Customer funds transfer activity includes high risk international jurisdictions, HIDTAs, HIFCAs or other areas classified by the bank as high risk</td>
<td>H</td>
<td>3</td>
</tr>
<tr>
<td>Customer activity does <strong>Not</strong> include funds transfer</td>
<td>L</td>
<td>0</td>
</tr>
</tbody>
</table>

*Activity which generate the funds*
### Foreign Politically Exposed Person

<table>
<thead>
<tr>
<th>Risk Factor</th>
<th>Rating</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer is a Foreign PEP</td>
<td>H</td>
<td>3</td>
</tr>
</tbody>
</table>
## Domestic Politically Exposed Person

<table>
<thead>
<tr>
<th>Risk Factor</th>
<th>Rating</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer is <strong>NOT</strong> considered a PEP</td>
<td>L</td>
<td>0</td>
</tr>
<tr>
<td>Customer is considered a PEP but has not been actively engaged or in office in over 10 years</td>
<td>M</td>
<td>2</td>
</tr>
<tr>
<td>Customer is considered a PEP and is actively engaged in office within less than 10 years</td>
<td>H</td>
<td>3</td>
</tr>
</tbody>
</table>
## The Risk Assessment

### Quantification

<table>
<thead>
<tr>
<th>Risk Factor</th>
<th>Rating</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wire transfer</td>
<td>H</td>
<td>3</td>
</tr>
<tr>
<td>Cash</td>
<td>H</td>
<td>3</td>
</tr>
<tr>
<td>Bank draft/Credit Card/Personal Cheque</td>
<td>L</td>
<td>0</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>Risk Factor</th>
<th>Rating</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Money laundering or terrorist financing suspected</td>
<td>H</td>
<td>3</td>
</tr>
<tr>
<td>Money laundering or terrorist financing not suspected</td>
<td>L</td>
<td>0</td>
</tr>
</tbody>
</table>
## Risk Scoring Process

<table>
<thead>
<tr>
<th>Exposure</th>
<th>Range</th>
<th>Identifier</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low (L)</td>
<td>1 to 15</td>
<td></td>
</tr>
<tr>
<td>Medium (M)</td>
<td>16 to 31</td>
<td></td>
</tr>
<tr>
<td>High (H)</td>
<td>Above 31</td>
<td></td>
</tr>
</tbody>
</table>
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