Money Laundering and Terrorist Financing Risk Assessment Guidelines for Financial Institutions

Bangladesh Financial Intelligence Unit
Bangladesh Bank

Preface

Recommendation 1 of Financial Action Task Force (FATF), the international standard setter on anti money laundering (AML) and combating terrorist financing (CFT) requires financial institutions and designated non-financial businesses and professions (DNFBPs) to identify, assess and take effective action to mitigate their money laundering and terrorist financing risks. This requirement is reflected in the Money Laundering Prevention Rules (MLPR) 2013. Rule 21 of MLPR 2013 contains that every Reporting Organization-Financial Institution (RO-FI) shall conduct periodic risk assessment and forward the same to the Bangladesh Financial Intelligence Unit (BFIU) for vetting. Rule 21 also contains that RO-FI shall utilize this risk assessment report after having vetted by BFIU.

To perform the responsibilities and exercises the power bestowed in the Money Laundering Prevention Act (MLPA) 2012, Anti Terrorism Act (ATA) 2009, Rules there under and to comply with the Recommendation 1 of FATF this guideline titled "Money Laundering and Terrorist Financing Risk Assessment Guidelines for Financial Institution" is prepared for all financial institutions working in Bangladesh and issued as per the provisions of section 23 (1) (d) of MLPA 2012 and section 15 (1) (d) of ATA 2009.

This guideline will provide the basic ideas of identifying, assessing and mitigating ML & TF risks that FIs may encounter in doing their businesses. These risks may arise through/from customers, product and services, business practices or delivery methods and jurisdictions or geographical presence. FIs may also face regulatory risks, i.e., non compliance with the requirements of MLPA 2012, ATA 2009 and directives issued by BFIU. In order to treat those identified risks FIs shall assess the level of risks by blending likelihood and impact of the risks.

This guideline shall be treated as minimum instructions and indications to identify, assess the risk of ML & TF in their businesses and take effective measures to mitigate the identified risk and monitor and review the risk management procedures and controls of ML & TF risk. It is important that all FIs will prepare their own risk assessment and mitigation report in line with this guideline and get approval from their competent authorities before forwarding the same to the BFIU for vetting. After getting vetted by BFIU, the risk assessment and mitigation report shall be communicated to relevant personnel within the FIs. FIs are allowed to use more stringent tools to identify and assess the risk of ML & TF in their institutions but

whatever the methods used the risk assessment and mitigation report should be updated or revised regularly.

It is to remember that the identified risks and measures taken into consideration by FIs to mitigate those risks in line with this guideline will be used as an input of Guidance Notes on prevention of Money Laundering which was issued under Managing Core Risks in FIs by Bangladesh Financial Intelligence Unit.

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List of Abbreviations

AML&CFT	**Anti-Money Laundering & Combating the Financing of Terrorism**
ATA	**Anti Terrorism Act**
BB	**Bangladesh Bank**
BFIU	**Bangladesh Financial Intelligence Unit**
CDD	**Customer Due Diligence**
DNFBPs	**Designated non-financial businesses and professions**
EDD	**Enhanced Due Diligence**
FATF	**Financial Actions Task Force**
FI	**Financial Institution**
IPs	**Influential Persons**
KYC	**Know Your Customer**
ML	**Money Laundering**
MLPA	**Money Laundering Prevention Act**
MLPR	**Money Laundering Prevention Rules**
PEPs	**Politically Exposed Persons**
RO-FI	**Reporting Organizations-Financial Institutions**
STR	**Suspicious Transaction Report**
SAR	**Suspicious Activity Report**
TF	**Terrorist Financing**

Chapter: One
Overview of ML&TF Risk

1. 1 Introduction

As a lead agency for prevention of money laundering and combating financing of terrorism, Bangladesh Financial Intelligence Unit (BFIU) is very keen to achieve highest success in this regard. The success of AML&CFT program highly depends on efficient assessment of related threat/vulnerability/risk and placing necessary tools for combating ML&TF risks as per the result of assessed threat/vulnerability/risk.

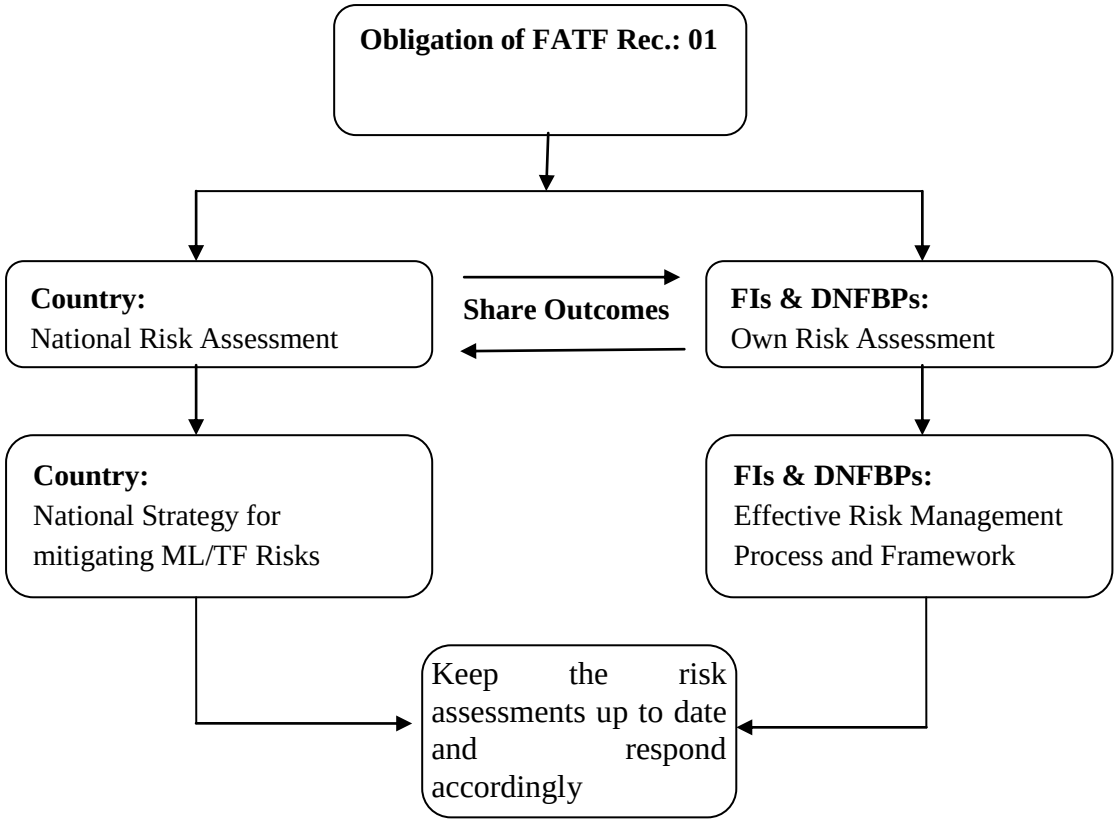
The purpose of this guideline is to:

- provide general information about ML & TF risks related with or generated through the products, services, delivery channels, and geographical presence;
- assist FIs to assess their ML&TF risks efficiently;
- enable FIs in implementing an AML & CFT program appropriate to their business having regard to the business size, nature and complexity;
- provide a broad risk management framework based on high-level principles and procedures that a FI may wish to consider when developing and implementing a risk-based approach to identify, mitigate and manage the ML & TF risks;
- enable the FIs to understand how and to what extent, it is vulnerable to ML&TF risks; and
- help FIs to allocate the resources efficiently to mitigate the Ml & TF risk.

1.2 Obligation for ML&TF Risk Assessment and Management

Recommendation 1 of Financial Action Task Force (FATF), the international standard setter on anti money laundering (AML) and combating terrorist financing (CTF) states that countries should require financial institutions and designated non-financial businesses and professions (DNFBPs) to identify, assess and take effective action to mitigate their money laundering and terrorist financing risks. Rule 21 of MLP Rules 2013 contains that every Reporting Organization-Financial Institution (RO-FI) shall conduct periodic risk assessment and forward the same to the Bangladesh Financial Intelligence Unit (BFIU) for vetting. Rule 21 also contains that RO-FI shall utilize this risk assessment report after having vetted by BFIU.

The obligation of FATF Recommendation-1 may be shown as follows:



Money Laundering Prevention Act, 2012 empowers BFIU sufficiently to establish a sound and efficient AML & CFT regime in Bangladesh. Every reporting organization has to comply with the instructions issued by BFIU under the power of Money Laundering Prevention Act (MLPA), 2012 and Anti Terrorism Act (ATA), 2009 (including all amendments). This Guideline has been issued through BFIU circular letter aiming to strengthen AML&CFT regime in Bangladesh. Therefore, it is obligatory for FIs to comply with this Guideline.

1.3 Assessing risk

FIs should be required to take appropriate steps to identify and assess their money laundering and terrorist financing risks arisen from or through customers, products or services and transactions or delivery channels and geographical presence. They should document those assessments in order to be able to demonstrate their basis, keep these assessments up to date, and have appropriate mechanisms to provide risk assessment information to competent authorities.

1.4 Risk management and mitigation

FIs should be required to have policies, controls and procedures that enable them to manage and mitigate effectively the risks that have been identified. They should be required to monitor the implementation of those controls and to enhance them, if necessary. The policies, controls and procedures must be approved by senior management, and the measures taken to manage and mitigate the risks (whether higher or lower) should be consistent with national requirements and with guidance from BFIU.

1.5 What is risk

Risk can be defined as the combination of the probability of an event and its consequences. In simple term, risks can be seen as a combination of the chance that something may happen and the degree of damage or loss that may result if it does occur.

1.6 What is risk management

Risk management is a systematic process of recognizing risk and developing methods to both minimize and manage the risk. This requires the development of a method to identify, assess, treat (deal with), control and monitor risk exposures. In risk management, a process is followed where the risks are assessed against the likelihood (chance) of them occurring and the severity or amount of loss or damage (impact) which may result if they do happen.

1.7 Which risks do FIs need to consider

For the AML & CTF aspects, FIs should take into account two main sources of ML & TF risks i.e., ML & TF risk arises from or through doing their business and non-compliance of regulatory requirements.

ML & TF risk that arises or generated in doing business is the risk that business may be used for ML & TF. The FIs must at least take into consideration the following segment of their business in assessing ML & TF risk:

- customer risks, i.e. ML&TF risk arisen from or generated through customers
- products or services risks
- business practices and/or delivery method risks
- country or jurisdictional risks

Regulatory risk is associated with not meeting all obligations of all FIs under the Money Laundering Prevention Act, 2012, Anti Terrorism Act, 2009 (including all amendments), the

respective Rules issued under these two Acts and instructions issued by BFIU. Examples of regulatory obligations are failure to report STR/SAR, unable or inappropriately verification of customers and lacking of AML&CFT program (how a business identifies and manages the ML&TF risk it may face) etc.

It is unrealistic that a FI would operate in a completely ML&TF risk-free environment. Therefore, it is suggested that a FI shall identifies the ML&TF risk it faces, and then works out the best ways to reduce and manage that risk.

Chapter: Two

Risk Management Framework

2.1 Introduction

The FIs will have flexibility to construct and tailor their risk management framework for the purpose of developing risk-based systems and controls and mitigation strategies in a manner that is most appropriate to their business structure (including financial resources and staff), their products and/or the services they provide. Such risk-based systems and controls should be proportionate to the ML&TF risk(s) a FI reasonably faces.

The risk management framework discussed in this guideline aims to assist FIs to develop and implement their AML&CFT programs in compliance with the existing legal and regulatory requirements and international standards and best practices.

For effective risk management, the FIs should at all levels follow the principles below:

- Risk management contributes to the demonstrable achievement of objectives and improvement of performance, governance and reputation.
- Risk management is not a stand-alone activity that is separate from the main activities and processes of the FI. Risk management is part of the responsibilities of management and an integral part of all organizational processes, including strategic planning.
- Risk management helps decision makers making informed choices, prioritize actions and distinguish among alternative courses of action.
- Risk management explicitly takes account of uncertainty, the nature of that uncertainty, and how it can be addressed.
- A systematic, timely and structured approach to risk management contributes to efficiency and to consistent, comparable and reliable results.
- Risk management is based on the best available information.
- Risk management is aligned with the FI's external and internal context and risk profile.
- Risk management is transparent and inclusive.
- Risk management is dynamic, iterative and responsive to change.

Following the above mentioned principles FIs are expected to develop and maintain logical, comprehensive and systematic methods to address each of the components referred to in this Guideline and that such methods and the FIs' approach to ML&TF risk are understood, implemented and maintained, to some appropriate extent, within their organizations.

FIs would be expected to demonstrate to BFIU and Bangladesh Bank (BB) (for example, when a BFIU/BB inspection is being conducted) that their risk based systems and controls are suitable to their particular business and consistent with prudent and good practices.

In assessing and mitigating ML & TF risk, the FIs should consider a wide range of financial products and services, which are associated with different ML & TF risks. These include, but are not limited to:

- Different deposit schemes: where FIs offer products and services directly to persons, business customers, Corporate bodies, Government offices, NGOs, Clubs, societies such as term deposit scheme, wealth builder scheme, other savings products;
- Corporate finance and investment services: where FIs provide corporate finance products such as lease finance, term loan, project finance, working capital finance, short-term finance and investment services to corporations, large and medium size enterprises, governments and institutions;
- Consumer finance: where FIs finance their customers to purchase different consumer products and services.

FIs should be mindful of those differences when assessing and mitigating the ML & TF risk to which they are exposed.

2.2 Risk Management Framework

A risk management framework would consist of:

(a) establishing the internal and external context within which the designated service is, or is to be, provided. These may include:

-the types of customers;

-the nature, scale, diversity and complexity of their business;

-their target markets;

-the number of customers already identified as high risk;

-the jurisdictions the FI is exposed to, either through its own activities or the activities of customers, especially jurisdictions with relatively higher levels of corruption or organized crime, and/or deficient AML & CFT controls and listed by FATF;

-the distribution channels, including the extent to which the FIs deals directly with the customer or the extent to which it relies (or is allowed to rely on) third parties to conduct CDD and the use of technology;

-the internal audit and regulatory findings;

-the volume and size of its transactions, considering the usual activity of the FIs and the profile of its customers.

(b) risk identification;

(c) risk assessment or evaluation; and

(d) risk treatment (mitigating, managing, control, monitoring and periodic reviews).

Figure 1: The risk management framework at a glance

- **Risk identification:**

Identify the main ML&TF risks:
• customers
• products & services
• business practices/delivery methods or channels
• country/jurisdiction

Identify the main regulatory risks:
- failure to report STRs/SARs
- inappropriate customer verification
- inappropriate record keeping
- lack of AML/CFT program

- **Risk assessment/evaluation**

Measure the size & importance of risk:
• likelihood – chance of the risk happening
• impact – the amount of loss or damage if the risk happened
• likelihood X impact = level of risk (risk score)

- **Risk treatment**

Manage the business risks:
• minimize and manage the risks
• apply strategies, policies and procedures

Manage the regulatory risks:
• put in place systems and controls
• carry out the risk plan and AML&CFT program

- **Risk monitoring and review**

Monitor and review the risk plan:
• develop and carry out monitoring process
• keep necessary records
• review risk plan and AML&CFT program
• do internal audit or assessment
• do AML&CFT compliance report

2.3 The risk management process

2.3.1 Risk identification

Identify the main ML&TF risks:
- customers
- products & services
- business practices/delivery methods or channels
- country/jurisdiction

Identify the main regulatory risks:
- failure to report STRs/SARs
- inappropriate customer verification
- inappropriate record keeping
- lack of AML&CFT program

The FI should identify sources of risk, areas of impacts, events (including changes in circumstances) and their causes and their potential consequences. The aim of this step is to generate a comprehensive list of risks based on those events that might create, enhance, prevent, degrade, accelerate or delay the achievement of objectives. It is important to identify the risks associated with not pursuing an opportunity. Comprehensive identification is critical, because a risk that is not identified at this stage will not be included in further analysis.

Identification should include risks whether or not their source is under the control of the organization, even though the risk source or cause may not be evident. Risk identification should include examination of the knock-on effects of particular consequences, including cascade and cumulative effects. It should also consider a wide range of consequences even if the risk source or cause may not be evident. As well as identifying what might happen, it is necessary to consider possible causes and scenarios that show what consequences can occur. All significant causes and consequences should be considered.

The FI should apply risk identification tools and techniques that are suited to its objectives and capabilities, and to the risks faced. Relevant and up-to-date information is important in identifying risks. This should include appropriate background information where possible. Personnel with appropriate knowledge should be involved in identifying risks.

In identification of ML & TF risk FIs must consider at least risk arisen doing its business i.e. its customers, products or services, delivery channels or methods and jurisdiction and risk of non-compliance.

- **ML & TF risk arises from Business:**

A FI must consider the risk posed by any element or any combination of the elements listed below:

- Customers
- Products and services
- Business practices/delivery methods or channels
- Countries it does business in/with (jurisdictions).

Under these four groups, individual risks to a bank can be determined. While not an exhaustive list, some of these individual risks may include:

- **Customers:** followings are some indicators (but not limited to) to identify ML & TF risk arises from customers of a FI.
  - a new customer
  - a new customer who wants to carry out a large transaction
  - a customer or a group of customers making lot of transactions and/or maintaining several accounts in the same name or group
  - a customer who has a business which involves large amounts of cash
  - a customer whose identification is difficult to check
  - customers conducting their business relationship or transactions in unusual circumstances, such as:
    - significant and unexplained geographic distance between the institution and the location of the customer
    - frequent and unexplained movement of accounts to different institutions
    - frequent and unexplained movement of funds between institutions in various geographic locations
  - a non- resident customer
  - a corporate customer whose ownership structure is unusual and excessively complex

- customers that are politically exposed persons (PEPs) or influential persons (IPs) or head of international organizations and their family members and close associates
- customers submits account documentation showing an unclear ownership structure
- customer opens account in the name of his/her family member who intends to credit large amount of deposits not consistent with the known sources of legitimate family income
- a customer comes with premature encashment of fixed deposit
- a customer generally tries to convince for cash deposit but insists for financial instrument while withdrawing the deposit
- a customer who wants to settle his loan early
- government employee having several large amounts of fixed deposit accounts

➢ **Products and services:**

- prioritized or privileged financial service
- credit card
- Syndicate financing
- anonymous transaction
- non face to face business relationship or transaction
- payment received from unknown or unrelated third parties
- Receivable financing
- Home equity and loan against FDR/deposits/financial instruments
- Sale and lease back facility
- any new product & service developed

➢ **Business practice/delivery methods or channels:**

- direct to the customer
- online/internet
- phone
- fax
- email
- third-party, agent or broker

- **Country/jurisdiction:**
    - any country which is identified by credible sources as having significant level of corruption and criminal activity
    - any country subject to economic or trade sanctions
    - any country known to be a tax haven and identified by credible sources as providing funding or support for terrorist activities or that have designated terrorist organizations operating within their country
    - any country identified by FATF or FSRBs as not having adequate AML&CFT system
    - any country identified as destination of illicit financial flow
    - branch in any land port, sea port city or any border area

- **Regulatory risk**

This risk is associated with not meeting the requirements of the Money laundering Prevention Act, 2012, Anti Terrorism Act, 2009 (including all amendments) and instructions issued by BFIU. Examples of some of these risks are:

- customer/beneficial owner identification and verification not done properly
- failure to keep record properly
- failure to scrutinize staffs properly
- failure to train staff adequately
- not having an AML&CFT program
- failure to report suspicious transactions or activities
- not submitting required report to BFIU regularly
- not having an AML&CFT Compliance Officer
- failure of doing Enhanced Due Diligence (EDD) for high risk customers (i.e., PEPs, IPs)
- not complying with any order for freezing or suspension of transaction issued by BFIU or BB
- not submitting accurate information or statement requested by BFIU or BB.

2.3.2. Risk assessment:

For assessing risk, in this chapter we have used, the Table -1, which is a simple & generic table with Risk Score and Treatment. Risk Score can be found by blending likelihood and impact; the details will be explained later on. Table -1 is used, only the examples of customer risk assessment and developed phase by phase so that user can have a good idea of risk assessment.

Table 1: Risk Management Worksheet – risk

Risk group:	**Customers**			
Risk	**Likelihood**	**Impact**	**Risk score**	**Treatment/Action**
New customer *(example only)*				
Customer who brings in large amounts of used notes and/or small denominations *(example only)*				
Customer whose business address and registered office are in different geographic locations *(example only)*				

A table similar to *Table 1* shown above - *Risk management worksheet* - could be used for each risk group in preparation for assessing and managing those risks: customers, products and services, business practices/delivery methods, country/jurisdiction and the regulatory risks. Compilation of all risk groups by following table-1 will be treated as risk register of that FI.

2.3.3. Calculation of Risk Score

Measure the size & importance of risk:
- likelihood – chance of the risk happening
- impact – the amount of loss or damage if the risk happened
- likelihood X impact = level of risk (risk score)

Having identified the risks involved, they need to be assessed or measured in terms of the chance (likelihood) they will occur and the severity or amount of loss or damage (impact) which may result if they do occur. The risk associated with an event is a combination of the chance (likelihood) that the event will occur and the seriousness of the damage (impact) it may do.

Therefore each risk element can be rated by:

- the chance of the risk happening – **'likelihood'**
- the amount of loss or damage if the risk happened – **'impact' (consequence)**.

To help assess the risks identified in the first stage of this process, we can apply the risk rating scales for likelihood *(Table 2) on page 15* and impact *(Table 3) on page 16* and from these get a level of risk or risk score using the risk matrix *(Figure 2) on page 16*.

LIKELIHOOD	X	IMPACT	=	RISK LEVEL/SCORE

- **Likelihood scale**

A likelihood scale refers to the potential of an ML&TF risk occurring in the business for the particular risk being assessed. Three levels of risk are shown in Table 2, but the FIs can have as many as they believe are necessary. This likelihood can be ascertained based on the available information, group consultation or by applying subjective judgment. FIs shall engage all concerned and competent personnel in ML & TF risk management process including ascertaining the likelihood scale.

Table 2: Likelihood scale

Frequency	Likelihood of an ML&TF risk
Very likely	**Almost certain: it will probably occur several times a year**
Likely	**High probability it will happen once a year**
Unlikely	**Unlikely, but not impossible**

- **Impact scale**

An impact scale refers to the seriousness of the damage (or otherwise) which could occur should the event (risk) happen.

In assessing the possible impact or consequences, the assessment can be made from several viewpoints. It does not cover everything and it is not prescriptive. Impact of an ML&TF risk could, depending on individual FI and its business circumstances, be rated or looked at from the point of view of:

- how it may affect the business (if through not dealing with risks properly the FI suffers a financial loss from either a crime or through fines from BFIU or regulator);
- the risk that a particular transaction may result in the loss of life or property through a terrorist act;
- the risk that a particular transaction may be involved in funds generated from any of the following crimes: corruption and bribery, counterfeiting currency, counterfeiting deeds and documents, smuggling of goods/workers/immigrants, banking offences, narcotics offences, psychotropic substance offences, illegal arms trading, kidnapping, terrorism, theft, embezzlement, or fraud, forgery, extortion, smuggling of domestic and foreign currency, black marketing, fraud etc.;
- the risk that a particular transaction may be involved in financing of terrorism;
- reputational risk – how it may affect the FI if it is found to have (unknowingly) aided an illegal act, which may mean BFIU or government sanctions and/or being shunned by the community of customers;
- how it may affect the wider community of customers if it is found to have aided an illegal act; the community may get a bad reputation as well as the business.

- Legal risk- how it may affect the FIs if it becomes a part of legal proceedings.

All these impacts should be considered during measurement of impact scale.

Table 3: Impact scale

Consequence	Impact – of an ML & TF risk
Major	**Huge consequences – major damage or effect. Serious terrorist act or large-scale money laundering.**
Moderate	**Moderate level of money laundering or terrorism financing impact.**
Minor	**Minor or negligible consequences or effects.**

- **Risk matrix and risk score**

Use the risk matrix to combine LIKELIHOOD and IMPACT to obtain a risk score. The risk score may be used to aid decision making and help in deciding what action to be taken in view of the overall risk. How the risk score is derived can be seen from the risk matrix *(Figure 2)* and risk score table *(Table 4)* shown below. Four levels of risk score are shown in Figure 2 and Table 4, but the FI can have as many as they believe are necessary.

Figure 2: Risk matrix

Threat level for ML/TF risk

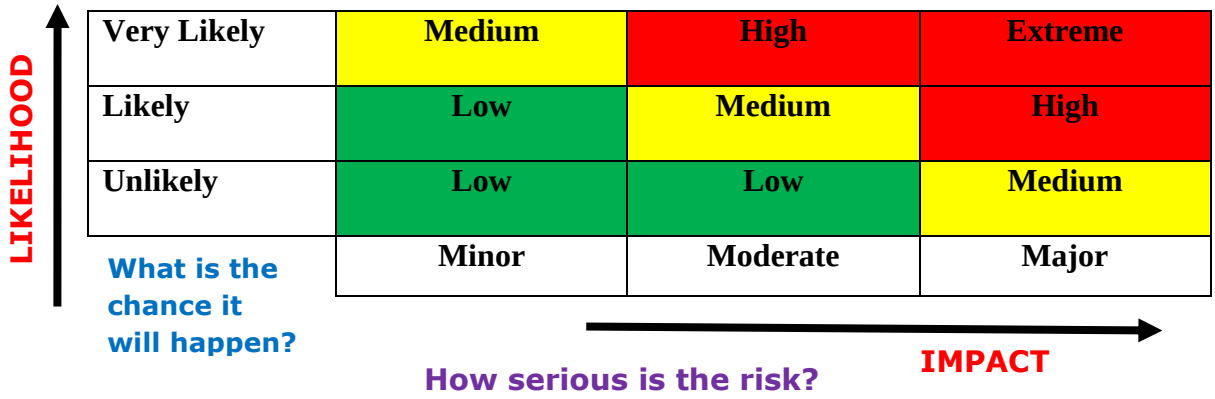


Table 4: Risk score table

Rating	Description
Extreme	**Risk almost sure to happen and/or to have very serious consequences.** **Response:** **Do not allow transaction to occur without reducing the risk to acceptable level- Follow EDD**
High	**Risk likely to happen and/or to have major consequences.** **Response:** **Do not allow transaction until risk is reduced- Follow EDD**
Medium	**Possible this could happen and/or have moderate consequences.** **Response:** **May go ahead but preferably reduce risk- Follow standard CDD**
Low	**Unlikely to happen and/or have minor or negligible consequences.** **Response:** **Okay to go ahead.**

- **Risk Assessment and Management Exercise:**

From the above discussion, the FIs will have an idea to calculate risk score by blending likelihood and impact, the risk matrix and risk score and can assess the risks of individual customer, product/service, delivery channel and risks related to geographic region by using the simplified risk management worksheet (Table-01). It can also fix up its necessary actions against the particulars outcomes of risks. All the exercises done by the FIs would be called together **"Risk Registrar"**.

Once threat levels and risk scores have been allocated FIs can be entered in the risk management worksheet *(Table 5)* next to the risk.

Table 5: Risk management worksheet – threat level and risk score

Risk group	**Customers**			
Risk	**Likelihood**	**Impact**	**Risk score**	**Treatment/Action**
New customer *(example only)*	**Likely *(example only)***	**Moderate *(example only)***	**Medium *(example only)***	
Customer who brings in large amounts of used notes and/or small denominations *(example only)*	**Likely *(example only)***	**Major *(example only)***	**High *(example only)***	
Customer whose business address and registered office are in the different geographic location *(example only)*	**Very likely *(example only)***	**Major *(example only)***	**Extreme *(example only)***	

2.3.4 Risk treatment

Manage the business risks:
- minimize and manage the risks
- apply strategies, policies and procedures

Manage the regulatory risks:
- put in place systems and controls
- carry out the risk plan and AML&CFT program

This stage is about identifying and testing methods to manage the risks the FI may have identified and assessed in the previous process. In doing this they will need to consider putting into place strategies, policies and procedures to help reduce (or treat) the risk. Examples of a risk reduction or treatment step are:

- setting transaction limits for high-risk products
- having a management approval process for higher-risk products
- process to place customers in different risk categories and apply different identification and verification methods
- not accepting customers who wish to transact with a high-risk country.

Table 6: Risk management worksheet – risk treatment or action

Risk group	**Customers**			
Risk	**Likelihood**	**Impact**	**Risk score**	**Treatment/Action**
New customer *(example only)*	Likely *(example only)*	Moderate *(example only)*	Medium *(example only)*	**Standard ID check = CDD**
Customer who brings in large amounts of used notes and/or small denominations *(example only)*	Likely *(example only)*	Major *(example only)*	High *(example only)*	**Standard + additional ID check = EDD**
Customer whose business address and registered office are in the different geographic location *(example only)*	Very likely *(example only)*	Major *(example only)*	extreme *(example only)*	**May be accepted following high levels of precautions**

Another way to reduce the risk is to use a combination of risk groups to modify the overall risk of a transaction. The FI may choose to use a combination of customer, product/service and country risk to modify an overall risk.

It is important to remember that identifying, for example, a customer, transaction or country as high risk does not necessarily mean that money laundering or terrorism financing is involved. The opposite is also true: just because a customer or transaction is seen as low risk does not mean the customer or transaction is not involved in money laundering or terrorism financing. Experience and common sense should be applied to the risk management process of an entity.

2.3.5 Monitor and review

Monitor & review the risk plan:
- develop and carry out monitoring process
- keep necessary records
- review risk plan and AML&CFT program
- do internal audit or assessment
- do AML&CFT compliance report

Keeping records and regular evaluation of the risk plan and AML & CFT program is essential. The risk management plan and AML&CFT program cannot remain static as risks change over time; for example, changes to customer base, products and services, business practices and the law.

Once documented, the FI should develop a method to check regularly on whether AML & CFT program is working correctly and effectively. If not, the FI needs to work out what needs to be improved and put changes in place. This will help keep the program effective and also meet the requirements of the AML & CFT Acts and respective Rules.

2.3.6 Additional tools to help risk assessment

The following tools or ideas can be useful in helping to manage risk. It can be included in the previous risk assessment process so that the decisions are to be better informed.

2.3.6.1 Applying risk appetite to risk assessment

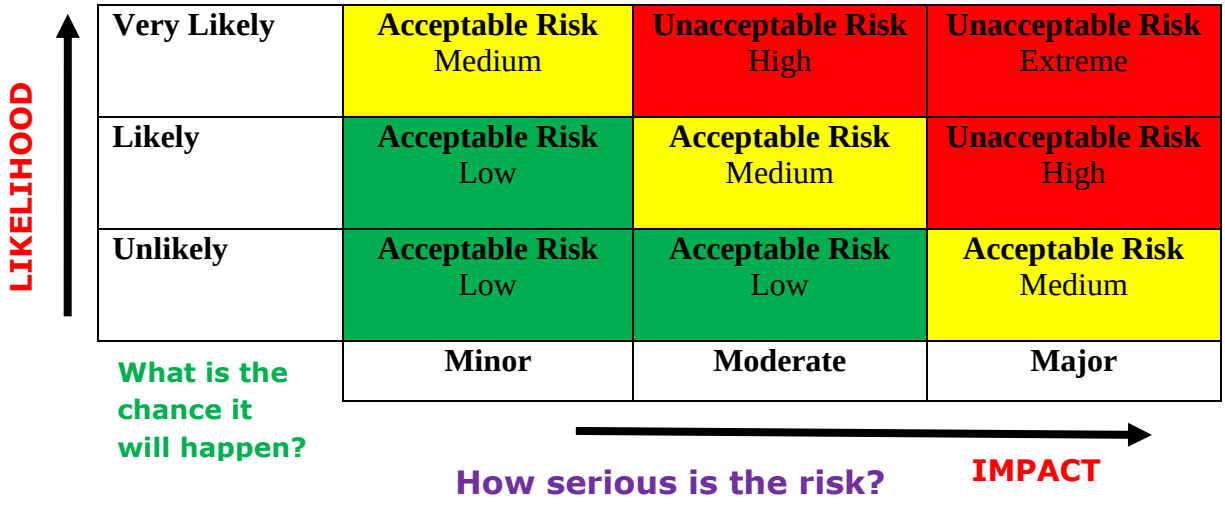
Risk appetite is the amount of risk a FI is prepared to accept in pursuit of its business goals. Risk appetite can be an extra guide to the risk management strategy and can also help deal with risks. It is usually expressed as an acceptable/unacceptable level of risk. Some questions to ask are:

- What risks will the FI accept?
- What risks will the FI not accept?
- What risks will the FI treat on a case by case basis?
- What risks will the FI send to a higher level for a decision?

The risk matrix can be used to show the risk appetite of the FI.

In a risk-based approach to AML & CFT the assessment of risk appetite is a judgment that must be made by the FI. It will be based on its business goals and strategies, and an assessment of the ML & TF risks it faces in providing the designated services to its chosen markets.

Figure 3: Sample risk matrix showing risk appetite



2.3.6.2 Risk tolerance

In addition to defining FI's risk appetite, the entity can also define a level of variation to how it manages that risk. This is called risk tolerance, and it provides some flexibility whilst still keeping to the risk framework that has been developed.

Chapter: Three

Risk management: some important issues

3.1 Risk Management Strategies

The FIs may adopt the following components (where appropriate to the nature, size and complexity of its business), among others, as part of its risk management strategy:

a) reviews at senior management level of the bank's progress towards implementing stated ML&TF risk management objectives

b) clearly defined management responsibilities and accountabilities regarding ML & TF risk management

c) adequate staff resources to undertake functions associated with ML & TF risk management

d) specified staff reporting lines from ML & TF risk management system level to board or senior management level, with direct access to the board member(s) or senior manager(s) responsible for overseeing the system

e) procedural controls relevant to particular designated services

f) documentation of all ML & TF risk management policies

g) a system, whether technology based or manual, for monitoring the bank's compliance with relevant controls

h) policies to resolve identified non-compliance

i) appropriate training program(s) for staff to develop expertise in the identification of ML & TF risk(s) across the bank's designated services

j) an effective information management system which should:

i) produce detailed and accurate financial, operational and compliance data relevant to ML & TF risk management

ii) incorporate market information relevant to the global AML & CFT environment which may assist the banks to make decisions regarding its risk management strategy

iii) enable relevant, accurate and timely information to be available to a relevant officer (for example, the AML & CFT Compliance Officer) within the FIs

iv) allow the FIs to identify, quantify, assess and monitor business activities relevant to ML & TF risk(s)

v) allow the FIs to monitor the effectiveness of and compliance with its internal AML & CFT systems and procedures

vi) allow the FIs to regularly assess the timeliness and relevance of information generated, together with its adequacy, quality and accuracy.

It should be noted that a FI can adopt other strategies in addition to taking into account of any of the above factors (where relevant), if it considers this approach is appropriate in accordance with its risk management framework.

3.2 Ongoing Risk Monitoring

A FI's ongoing monitoring of its risk management procedures and controls may also alert the FI to any potential failures including (but not limited to):

a) failure to include all mandatory legislative components

b) failure to gain board and/or executive approval of the AML & CFT program

c) insufficient or inappropriate employee due diligence

d) frequency and level of risk awareness training not aligned with potential exposure to ML & TF risk(s)

e) changes in business functions which are not reflected in the AML & CFT program (for example, the introduction of a new product or distribution channel)

f) failure to undertake independent review (at an appropriate level and frequency) of the content and application of the AML & CFT program

g) legislation incorrectly interpreted and applied in relation to a customer identification procedure

h) customer identification and monitoring systems, policies and procedures that fail to:

i) prompt, if appropriate, for further identification and/or verification when the ML & TF risk posed by a customer increases

ii) detect where a customer has not been sufficiently identified and prevent the customer from receiving the designated service

iii) take appropriate action where a customer provides insufficient or suspicious information in relation to an identification check

iv) take appropriate action where the identification document provided is neither an original nor a certified copy

v) recognize foreign identification documentation issued by a high risk jurisdiction

vi) record comprehensive details of identification documents, for example, the date of issue

vii) consult appropriate resources in order to identify high-risk customers

viii) identify when an expired or old identification document (for example, a driver's license) has been used

ix) collect any other name(s) by which the customer is known

i) lack of access to information sources to assist in identifying higher risk customers (and the jurisdictions in which they may reside), such as PEPs, terrorists and narcotics traffickers

j) lack of ability to consistently and correctly train staff and/or third parties, particularly in areas with high turnover in:

i) customer identification policies, procedures and systems

ii) identifying potential ML & TF risks

k) acceptance of documentation that may not be readily verifiable.

3.3 Higher risk scenario

When assessing the money laundering and terrorist financing risks relating to types of customers, countries or geographic areas, and particular products, services, transactions or delivery channels, examples of potentially higher-risk situations include the following:

a) Customer risk factors

- The business relationship is conducted in unusual circumstances (e.g. significant unexplained geographic distance between the financial institution and the customer)
- Non-resident customers
- Legal persons or arrangements that are personal asset-holding vehicles
- Companies that have nominee shareholders or shares in bearer form
- Business that are cash-intensive
- The ownership structure of the company appears unusual or excessively complex given the nature of the company's business

b) Country or geographic risk factors

- Countries identified by credible sources, such as mutual evaluation or detailed assessment reports or published follow-up reports, as not having adequate AML & CFT systems
- Countries subject to sanctions, embargos or similar measures
- Countries identified by credible sources as having significant levels of corruption or other criminal activity
- Countries or geographic areas identified by credible sources as providing funding or support for terrorist activities, or that have designated terrorist organizations operating within their country

c) Product, service, transaction or delivery channel risk factors

- Priority financial service
- Anonymous transactions (which may include cash)
- Non-face-to-face business relationships or transactions
- Payment received from unknown or un-associated third parties.

3.4 Lower risks Scenario

There are circumstances where the risk of money laundering or terrorist financing may be lower. When assessing the money laundering and terrorist financing risks relating to types of customers, countries or geographic areas, and particular products, services, transactions or delivery channels, examples of potentially lower risk situations include the following:

a) Customer risk factors

- FIs – where they are subject to requirements to combat money laundering and terrorist financing consistent with the FATF Recommendations, have effectively implemented those requirements, and are effectively supervised or monitored in accordance with the Recommendations to ensure compliance with those requirements
- Public companies listed on a stock exchange and subject to disclosure requirements (either by stock exchange rules or through law or enforceable

means), which impose requirements to ensure adequate transparency of beneficial ownership

- Public administrations or enterprises.

b) Product, service, transaction or delivery channel risk factors:

- Financial products or services that provide appropriately defined and limited services to certain types of customers, so as to increase access for financial inclusion purposes.

(c) Country risk factors

- Countries identified by credible sources, such as mutual evaluation or detailed assessment reports, as having effective AML & CFT systems
- Countries identified by credible sources as having a low level of corruption or other criminal activity. In making a risk assessment, countries or financial institutions could, when appropriate, also take into account possible variations in money laundering and terrorist financing risk between different regions or areas within a country.

Note that having a lower money laundering and terrorist financing risk for identification and verification purposes does not necessarily mean that the same customer poses lower risk for all types of CDD measures, in particular for ongoing monitoring of transactions.

3.5 Risk variables

When assessing the money laundering and terrorist financing risks relating to types of customers, countries or geographic areas, and particular products, services, transactions or delivery channels risk, a bank should take into account risk variables relating to those risk categories. These variables, either singly or in combination, may increase or decrease the potential risk posed, thus impacting the appropriate level of CDD measures. Examples of such variables include:

- The purpose of an account or relationship
- The level of assets to be deposited by a customer or the size of transactions undertaken
- The regularity or duration of the business relationship.

3.6 Counter Measures for Risk

3.6.1 Enhanced due diligence measures

FIs should examine, as far as reasonably possible, the background and purpose of all complex, unusual large transactions, and all unusual patterns of transactions, which have no apparent economic or lawful purpose. Where the risks of money laundering or terrorist financing are higher, FIs should be required to conduct enhanced due diligence (EDD) measures for higher-risk business relationships include:

- Obtaining and verifying additional information on the customer (e.g. occupation, volume of assets, information available through public databases, internet, etc.), and updating more regularly the identification data of customer and beneficial owner
- Obtaining and verifying additional information on the intended nature of the business relationship
- Obtaining and verifying information on the source of funds or source of wealth of the customer
- Obtaining and verifying information on the reasons for intended or performed transactions
- Obtaining and verifying the approval of senior management to commence or continue the business relationship
- Conducting enhanced monitoring of the business relationship, by increasing the number and timing of controls applied, and selecting patterns of transactions that need further examination
- Requiring the first payment to be carried out through an account in the customer's name with a bank subject to similar CDD standards.

3.6.2 Simplified CDD measures

Where the risks of money laundering or terrorist financing are lower, the FIs are allowed to conduct simplified CDD measures, which should take into account the nature of the lower risk. The simplified measures should be commensurate with the lower risk factors (e.g. the simplified measures could relate only to customer acceptance measures or to aspects of ongoing monitoring). Examples of possible measures are:

- Verifying the identity of the customer and the beneficial owner after the establishment of the business relationship (e.g. if account transactions rise above a defined monetary threshold)
- Reducing the frequency of customer identification updates
- Reducing the degree of on-going monitoring and scrutinizing transactions, based on a reasonable monetary threshold
- Not collecting specific information or carrying out specific measures to understand the purpose and intended nature of the business relationship, but inferring the purpose and nature from the type of transactions or business relationship established. Simplified CDD measures are not acceptable whenever there is a suspicion of money laundering or terrorist financing, or where specific higher-risk scenarios apply.

3.7 Ongoing due diligence

FIs should be required to ensure that documents, data or information collected under the CDD process is kept up-to-date and relevant by undertaking reviews of existing records, particularly for higher-risk categories of customers.