

Customer due diligence and the risk-based approach

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SECTION ONE

The risk-based approach

The risk-based approach: Introduction

3

✓ JMLSG - Chapter 4

✓ Core obligations:

- ✓ Appropriate systems and controls must reflect the degree of risk associated with the business and its customers
- ✓ Determine appropriate CDD measures:
 - Type of customer
 - Business relationship
 - Product or transaction
- ✓ Take into account higher risk situations. E.g.
 - Customer not present
 - Correspondent banking relationships
 - Transactions involving PEPs

“.....there is no requirement or expectation that a risk based approach must involve a complex set of procedures to put it into effect, the particular circumstances of the firm will determine the most appropriate approach”

The risk-based approach: Introduction

4

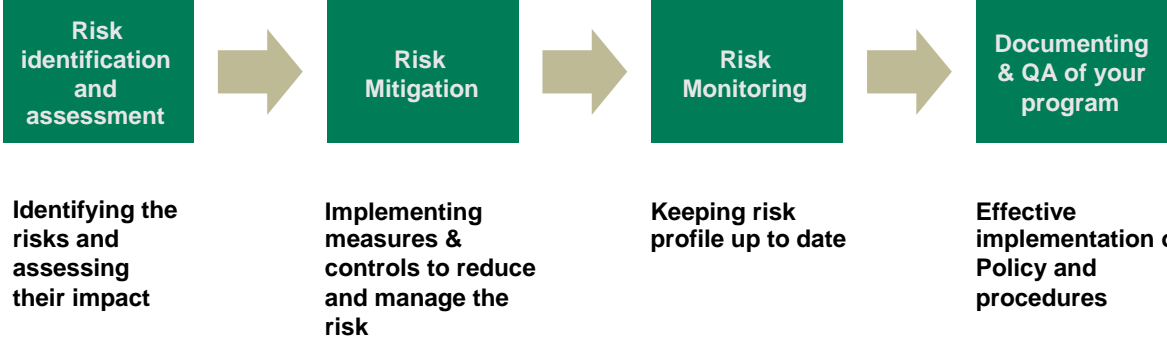
✓ Actions to be kept under regular review

- ✓ Carry out a risk assessment:
 - Formal and regular
 - Cover money laundering and terrorist financing
 - Consider all aspects of financial crime if responsibilities extend wider
 - Include market changes, changes in products and strategy, customer profiles and the wider environment
- ✓ Revisit internal procedures and the systems and controls in place, including staff awareness to ensure that it is adequately reflected in the risk assessment
- ✓ Do the on boarding requirements reflect the risk posed by customers?
- ✓ Revisit monitoring systems to ensure that they continue to reflect the risks posed

The risk-based approach: AML-CTF programme

Risk-based approach

✔ Risk Principles:



The risk-based approach: Getting Started

6

✓ Most financial institutions now have some form of risk template for risk assessments e.g. Operational Risk

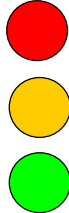
✓ The process:

- ✓ MLRO should prepare a suitable risk template and discuss and agree this with the nominated senior manager. It should be appropriate for the level and nature of business to be conducted
- ✓ Identify the ML, terrorist financing and associated financial crime risks relevant to the firm
- ✓ Assess the risks presented by: (as previous)
 - Customers
 - Products
 - Delivery channels
 - Geographical areas of operation
- ✓ Use the agreed risk profile as a start point for future reporting i.e. illustrate and/or include in the annual MLRO report.
- ✓ Develop strategic Key Performance Indicators (KPIs) from the risk template

✓ Advocate Simplicity

The risk-based approach: Sample Template

✔ Example of Simple Risk Monitoring Template

Ref #	Identified Risk / Issue	Action required to control	Outputs from monitoring	Status Red/ Amber/ Green
#	A firm must ensure that it has systems and controls: – to enable it to identify, assess, monitor and manage money laundering risk; and -- are comprehensive and proportionate to the nature, scale and complexity of its activities.	Senior Managers review all policies and procedures.	Senior Managers to establish the Key Performance Indicators – frequency and detail	

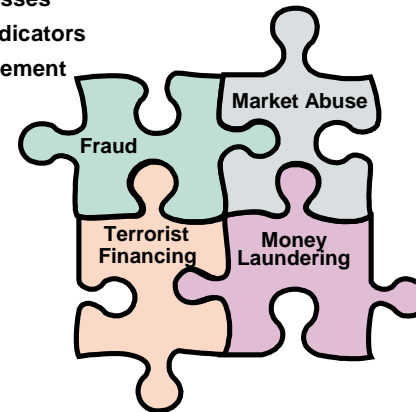
✔ This template can be used as a tool to assess all your financial crime risks, including but not limited to Sanctions, Fraud, Bribery & Corruption

The risk-based approach = Financial Crime Risk Assessment

8

✓ How do you go about it?

- ✓ Implementing a financial crime framework for good operational business sense as opposed to pure compliance purposes
- ✓ Best practice risk scoring methodologies used to assess potential risks by jurisdiction, product, client type
 - The correct data extraction can be a key assistance here
- ✓ Analysis of results
- ✓ Assigning appropriate resources to each identified risk type
- ✓ Customer identification, due diligence and continuous review processes
- ✓ Financial crime governance: key risk indicators, key performance indicators
- ✓ Escalating issues and communicating effectively with senior management
- ✓ Annual risk review process



SECTION TWO

Customer due diligence and the risk-based approach

Customer due diligence

10

Core obligations

- ✓ **Must carry out prescribed CDD measures for all customers not covered by exemptions**
- ✓ **Must have systems to deal with identification issues in relation to those who cannot produce the standard evidence**
- ✓ **Must apply enhanced due diligence to take account of those posing greater risk – specifically:**
 - ✓ **PEPs**
 - ✓ **Correspondent banking**
 - ✓ **Customer not present**
- ✓ **If unable to provide satisfactory evidence – must not proceed**
- ✓ **Must have a system for keeping information up to date**

The test:

A firm must ensure that these systems and controls:

- 1) enable them to identify, assess, monitor and manage money laundering risk
- 2) are comprehensive and proportionate to the nature, scale and complexity of its activities

Customer due diligence - SDD

11

✓ Existing Customers

- ✓ Firms must apply CDD measures at appropriate times to existing customer base
- ✓ Relevant to the risk posed by the customers to the business
- ✓ Consider the customer type, geography, products, flow of funds

✓ Simplified due diligence (SDD)

- ✓ What does this mean?
- ✓ JMLSG "...this means not having to verify the customer's identity...."
- ✓ Still necessary to conduct ongoing monitoring of the business relationship
- ✓ SDD can be applied to:
 - Certain other regulated firms
 - Companies listed on a regulated market
 - Beneficial owners of pooled accounts held by notaries or independent legal professionals
 - Etc...(JMLSG 5.4.2)
- ✓ SDD can be applied to low risk products which meet certain criteria
- ✓ Remember you still have to monitor for activity and sanctions and does not remove the need report where you have a suspicion

Customer due diligence - EDD

12

- ✓ **Enhanced due diligence applied on a risk-sensitive basis**
 - ✓ Where identified higher risk of money laundering or terrorist financing.
 - ✓ In order to apply the risk-based approach important to hold sufficient information to make the decisions
 - ✓ Seek out additional information and verify where an increased risk is apparent. The ML regulations identify 3 specifics:
 - Customer not physically present
 - Correspondent banking relationships
 - PEPs

- ✓ **Measurement of the risk-based approach will be based on the policies and procedures that you have put into place.**
- ✓ **Do you apply them as prescribed?**
- ✓ **From a sample of files would you have transparency and be able to demonstrate that you have applied a risk-based approach in accordance with the risk assessments that you have completed?**

Summary

Summary

14

- ✓ JMLSG provides advice and good practice in how to meet regulatory and legal obligations. The JMLSG is a good place to start **but remains guidance**

- ✓ However, **financial crime is wider than just anti-money laundering controls and a clear risk-based approach to financial crime overall is required**

- ✓ Let's recap on the key fears that a firm faces –
 - May not be capturing all its risks;
 - May not have sufficient controls in place;
 - May not have evidenced sufficiently how it assessed and managed the risk

- ✓ **Recall and conclude: Senior Managers must make sure they have the information to manage the risks – and understand how the controls give them the comfort that systems are effective. Make sure the MI produced is relevant.**