



Risk Assessment: Risk Factors & Mitigating Measures

Yanika Pisani
Legal Affairs



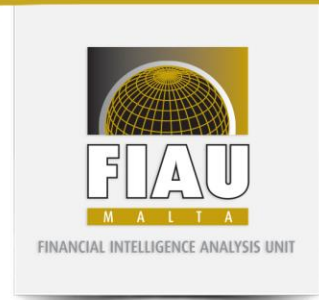
Level of Inherent Risk – Mitigating Measures = Level of Residual Risk

To properly assess the level of inherent risk, in both the Business Risk Assessment (BRA) and the Customer Risk Assessment (CRA), the threats and vulnerabilities to which one is exposed to must be taken into account.

Risk Factors

- Risk factors are those variables that either on their own or in combination with each other may increase or decrease the ML/FT risk posed to a subject person.
- Thus, a holistic view of the risk associated with a particular business relationship or occasional transaction needs to be implemented.
- To assess the risk to which the subject person is exposed to, subject persons should be satisfied that they have identified **all** the relevant risk factors in a given situation.
- Industry sectors and other general risk factors should also be referenced in the BRA.



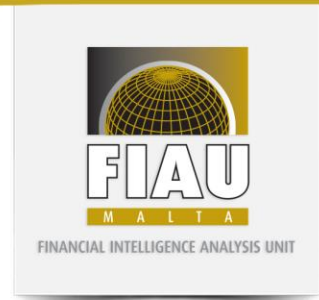


Risk Factors

Information on ML/FT risk factors could come from a variety of sources.

The sources could include:

- national and supranational risk assessments;
- information published by law enforcement agencies such as threat reports, alerts and typologies;
- information published by the Commission, such as warnings and the reasoning set out in enforcement actions taken by it;
- information from international standard-setting bodies, such as guidance papers and reports on specific threats or risks, as well as mutual evaluation reports when considering the risks associated with a particular country or geographic area;
- information provided by industry bodies, such as typologies and emerging risks;
- information published by reputable non-governmental organisations; and
- information published by credible and reliable open sources.



Risk Factors

In Regulation 5(1), the PMLFTR makes reference to the risk factors which must be taken into account by subject persons in their risk assessments. These include ***“...those relating to customers, countries or geographical areas, products, services, transactions and delivery channels”***.

Therefore, your risk assessments must take into account the following risk categories:

1. Customer Risk;
2. Geographical Risk (*to be tackled separately*);
3. Product, Service and Transaction Risk; and
4. Delivery Channels Risk (or Interface Risk).

Customer Risk

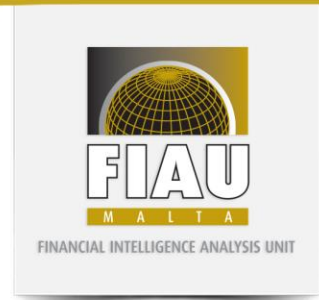


Customer risk is the risk of ML/FT that arises from entertaining relations with a given person or entity.

Customer Risk

Examples of ML/FT **high risk indicators** vis-à-vis customer:

- The customer is a business which is cash-intensive or cash equivalent;
- The customer is a legal person or arrangement that is a personal asset-holding vehicle;
- The customer is a company which has nominee shareholders or shares in bearer form;
- The customer is the family member or a close business associate or is himself/herself a PEP or holds a prominent public position that may be exploited for his/her personal advantage;
- The ownership structure of the company (the customer) appears unusual or needlessly complex given the nature of the company's business;
- The customer is resident in geographical areas of higher risk;



Customer Risk

Examples of ML/FT **high risk indicators** vis-à-vis customer (*cont.*):

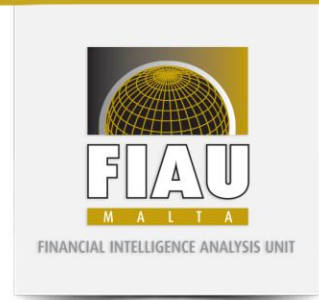
- The customer pursues activity commonly associated with a higher risk of corruption;
- The customer's activity is associated with a higher risk of ML/FT;
- The customer is a voluntary organisation whose primary activity is to raise or disburse funds for charitable, religious, cultural, educational or social purposes, and especially when these funds are remitted to third countries, which funds may be misused for the funding of terrorism;
- The customer is a third country national who applies for residence rights or citizenship in exchange of capital transfers, purchase of property or government bonds, or investment in corporate entities.



Customer Risk, specific to the CRA

When identifying the risks associated with their customers, subject persons should consider:

1. The customer's and/or the UBO business or professional activity;
2. The customer's and/or the UBO reputation; and
3. The customer's and/or the UBO nature and behaviour.



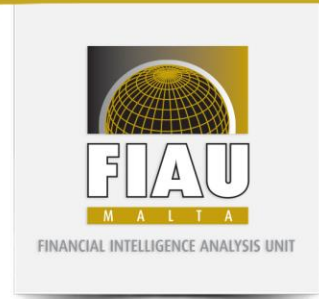
Risk associated with the Customer's Business or Professional Activity

- Does the customer or BO have links to sectors that are commonly associated with higher corruption risk or higher ML/FT risks?
- Does the customer or BO have links to sectors that involve significant amounts of cash?
- Where the customer is a legal person or a legal arrangement, what is the purpose of their establishment? What is the nature of their business?
- Does the customer have political connections?
- Does the customer hold another prominent position or enjoy a high profile that might enable them to abuse this position for private gain?
- Is the customer a credit or financial institution acting on its own account from a jurisdiction with an effective AML/CFT regime and is supervised for compliance with its local AML/CFT obligations?
- In the case of customers already onboarded or where another occasional transaction has been carried out: is the customer or the BO's background consistent with what the SP already knows about their planned business activity, their business turnover, the source of their funds, and their source of wealth?



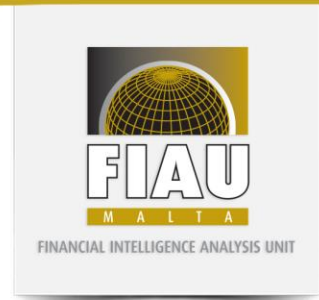
Risk associated with the Customer's Reputation

- Are there adverse media reports or other relevant sources of information about the customer? Are the sources credible and reliable?
- Does the SP have any in-house information about the customer's or the BO's integrity?
- Does the SP know or suspect that the customer has been subject of an STR in the past?



Risk associated with the Customer's Nature and Behaviour

- Does the customer have legitimate reasons for being unable to provide evidence of their identity?
- Does the SP have any doubts about the veracity or accuracy of the customer's or the BO's identity?
- Are there indications that the customer might seek to avoid the establishment of a business relationship?
- Is the customer's ownership and control structure transparent? Does it make sense?
- Does the customer request unnecessary or unreasonable levels of secrecy? Is he/she reluctant to share CDD information? Does he/she appear to want to disguise the true nature of their business?
- Can the customer's or the BO's SoW or SoFs be easily explained, for instance, through their occupation, inheritance or investments? Is this plausible?
- Does the customer request transactions that are complex, unusually or unexpectedly large, or have an unusual or unexpected pattern without an apparent economic or lawful purpose or a sound commercial rationale?



Customer Risk

Examples of ML/FT **low risk indicators** vis-à-vis customer:

- Entities that form part of the public administration or public enterprise;
- Entities that carry out relevant financial business or equivalent activities subject to equivalent AML/CFT obligations as those applicable in Malta, and which are subject to effective supervision;
- Entities listed on a regulated market and are subject to enforceable disclosure requirements, which ensure adequate transparency of beneficial ownership.

Product, Service or Transaction Risk

The product, service, or transaction risk is the risk to which the subject person is exposed to as a result of:

- ❖ providing a given product;
- ❖ providing a given service; or
- ❖ carrying out a particular transaction.

Products, services or transactions may permit or facilitate the anonymity of the identity of the customer or the BO.

Much will depend on:

1. The level of **transparency** or opaqueness that the product, service or transaction affords;
2. The **complexity** of the product, service or transaction; and
3. The **value or size** of that the product, service or transaction.

Product, Service or Transaction Risk

Questions which the subject person may ponder:

- To what extent do products or services allow the customer or BO to remain anonymous, or facilitate hiding their identity?
- To what extent is it possible for a third party that is not a part of the business relationship to give instructions?
- To what extent is the transaction complex and does it involve multiple parties or multiple jurisdictions? Are transactions straightforward?
- To what extent do products or services allow payments from third parties where this is not normally expected?
- Is the product cash intensive?
- Does the product or service facilitate or encourage high-value transactions? Are there any caps on transaction values that could limit the use of the product or service for ML/FT purposes?

Delivery Channels Risk (Interface Risk)

The delivery channel or interface risk is the risk arising from how the subject person interacts with the customer and the channels it uses to provide a given product or service. Some delivery channels/servicing methods can increase the risk of ML because they increase the risk that the SP does not truly know or understand the identity and activities of the customer.

Thus, the SP must assess whether, and to what extent, these delivery channels pose a risk. Some examples are:

- Non-face-to-face interactions. *Are mitigating measures being employed by the SP?*
- Intermediaries. *Are these reliable?*
- Introducers. *What is the nature of their relationship with the SP?*



To sum up...

- In addition to the individual consideration of each risk factor, SPs must also consider all such factors holistically to establish whether their effect might increase or decrease your overall business risk exposure and the dynamic that this could have on the controls implemented by the firm to mitigate risk.
- There are also other industry specific risk factors and other factors such as outsourcing which may increase the overall level of risk. These factors should be considered in conjunction with the firm's ML/FT risks.
- Having identified where it is vulnerable and the threats that it faces, SPs should take appropriate steps to mitigate the opportunity for those risks to materialise. This will involve determining the necessary controls or procedures that need to be in place in order to reduce the ML/FT risks identified while conducting the risk assessment to stay within your risk tolerance level.
- **Risk factors are not static!** They may change over time or new ones introduced.

Mitigating Measures



Risk mitigation involves the development and implementation of strategies, policies and procedures which are targeted at moderating the identified risks to which the business is exposed.

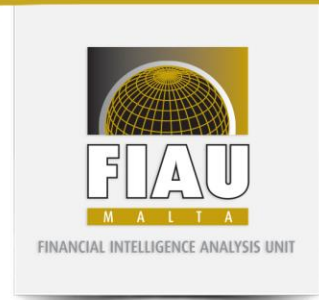
Risk mitigating measures are to be applied on a risk-sensitive basis.



Mitigating Measures

Some risk mitigating measures which SPs can implement are:

- Strengthening and adopting internal controls and measures suitable to target the risk posed;
- Ensuring that any measures, policies, controls and procedures are clearly documented and, where necessary, approved by senior management;
- Conducting the correct level of CDD tailored to the customer's risk profile, including the intensity of ongoing monitoring;
- Setting transaction limits and transaction monitoring;
- Prohibiting certain business/clients which fall(s) outside the business' risk appetite;
- Training and awareness for the employees of the subject person;
- Keeping abreast with any developments in AML/CFT legislation and internationally identified risks and typologies;
- Ensuring adequate employee screening;
- Having a trained, skilled, and experienced MLRO;
- Implementing a culture of effective internal reporting and external reporting;
- The appointment of compliance officer/s;
- The implementation of an independent audit function to test the SP's internal measures, policies, controls and procedures from time to time.



Mitigating Measures

Prior to the onboarding a customer or carrying out an occasional transaction, subject persons must:

- Undertake a BRA;
- Undertake a relationship risk assessment (the CRA);
- Based on the outcome of its relationship risk assessment, the SP should decide whether or not to accept (or continue) a business relationship or whether or not to carry out an occasional transaction.

Subject persons must also:

- When undertaking or reviewing a relationship risk assessment, understand that the risk factors present in a given situation, either in isolation or in combination, may increase or decrease the potential risk posed by the business relationship or occasional transaction.
- Regularly review the risk assessments carried out so as to keep it up-to-date, and where changes occur and these are to be taken into consideration in the risk assessment, SPs must implement those changes.

OVERVIEW OF MONEY LAUNDERING

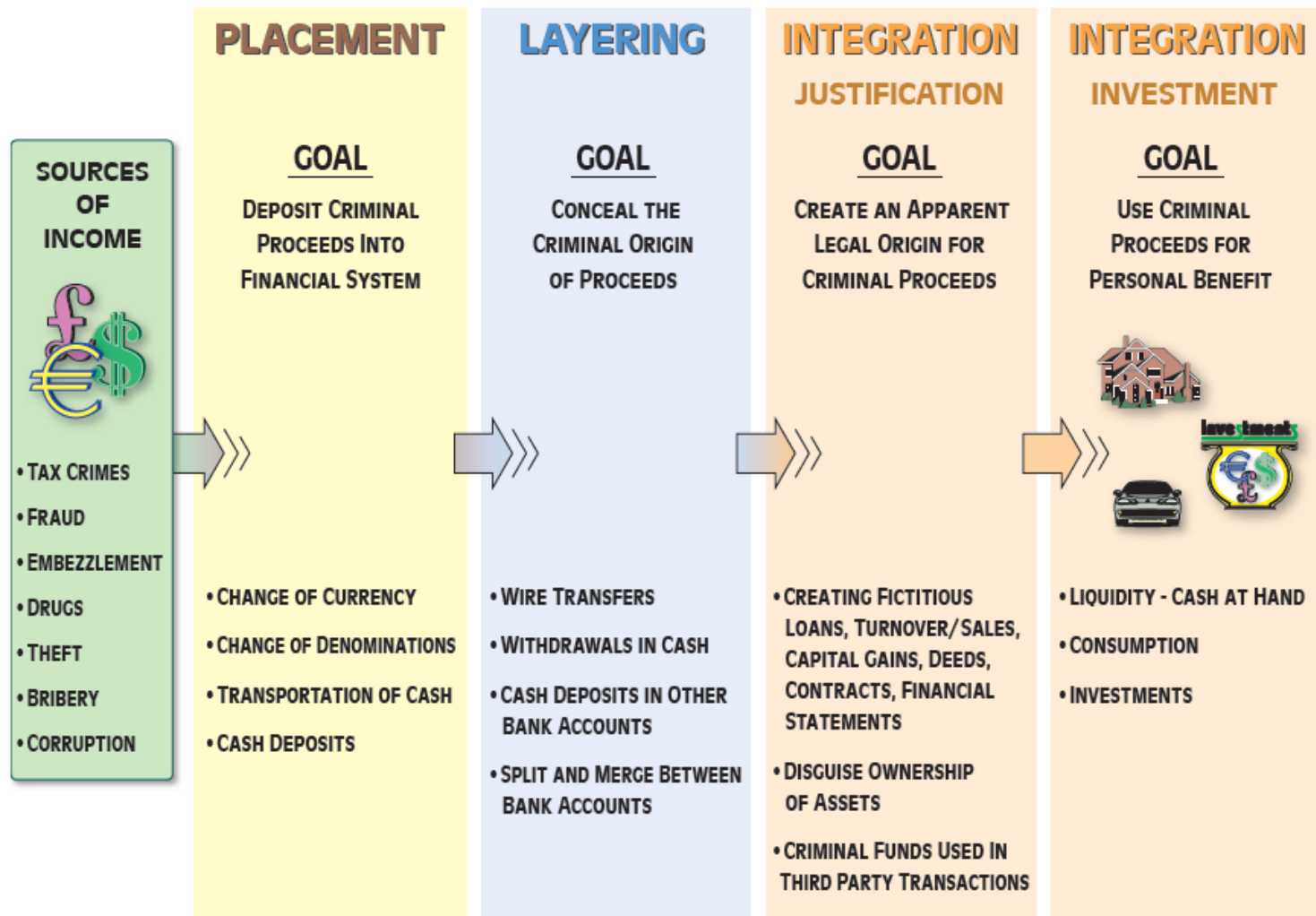
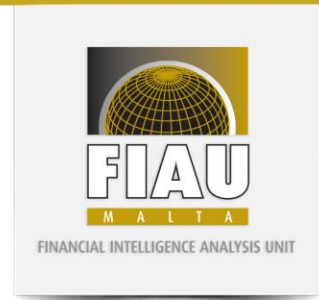


Image extracted from OECD 2009



Case Study 1

Facts of the case:

- Mr X is seeking to purchase a property. He approaches a real estate agent and informs him that he has a budget of €500,000.
- He does not appear to be too choosy on the specifics. He only requests that the property is located in an area of high property demand.
- He insists that he is time constrained and wishes to purchase a property as soon as possible.
- When the real estate agent finds a suitable property, he does not show any particular interest and does not ask many questions. He views the property once, and informs the seller that he wants to buy the property.

Case Study 1 (cont.)

Facts of the case (cont.):

- During the promise of sale, he informs the seller that he has no objection to pay the asking price of the property in full, but he has some cash he wishes to use as a part payment, and wishes to pay this “under-the-table”. He requests to have a formal payment of €350,000 reflected within the promise of sale and the eventual sale agreement to reflect this sale amount.
- The seller accepts and eventually the sale is concluded.
- Shortly after, Mr X informs the real estate agent that he wants to re-sell the same property.
- He requests to sell the property at the same price that he actually paid including the under-the-table payment (€500,000).
- Thus, it appears that he has made a profit of €150,000.

Case Study 1 (cont.)

Identification of the red flags:

- The fact that the customer was not choosy on the specifics of the property and he was practically disinterested in the details.
- The fact that the customer wanted to conclude the sale as quickly as possible.
- The “under-the-table” cash payment.
- The resale in a relatively short amount of time (property flipping).

Property flipping

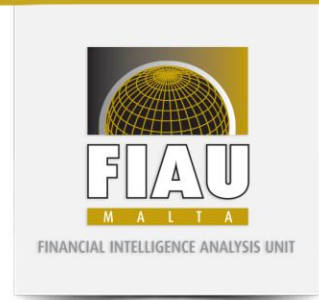
Two or more transactions relating to the same property take place within a relatively short amount of time. This method is used to launder criminal proceeds in the following manner: the buyer pays more than the documented purchase price, and when he/she resells the property at the same price that he/she actually paid for it, it appears that he/she made a profit. As a result of this transaction, the criminal proceeds would have been converted to apparent legitimate funds.

Case Study 1 (cont.)

Other possible indicators to be considered by the Subject Person:

- Whether the customer has a criminal background;
- The involvement of third parties in the transaction;
- The customer's budget or value of the property being acquired appear too high for the customer's occupation and profile;
- Unusual transaction prices which do not reflect the property market.





Case Study 1 (*cont.*)

What AML/CFT mitigating measures could have implemented by the Subject Persons?

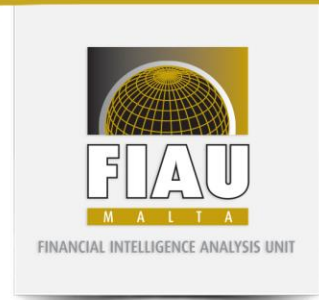
- Conducting a thorough CRA;
- More rigorous CDD since a series of red flags were present;
- Drop the customer if he/she falls outside the SPs risk appetite;
- File an STR.

Case Study 2

Facts of the case:

- A firm of accountants adopted an aggressive foreign expansion strategy so as to increase its profitability and market share, particularly in the international market. For this reason, it also established alliances and cooperation with a number of small-to-medium sized law firms which also sought to expand their business.
- The firm appointed a compliance officer with limited compliance and AML experience, who was assisted by a junior employee without any prior experience in compliance.

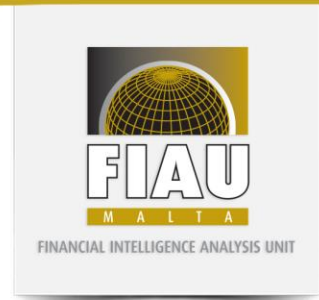




Case Study 2 (cont.)

Facts of the case (cont.):

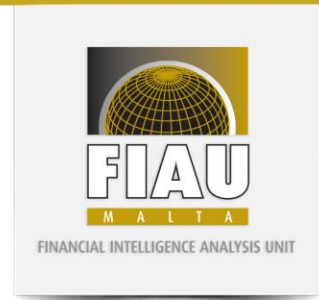
- The company adopted a CAP based on two risk factors:
 1. Whether the client is a PEP (PEPs were identified using a reputable web check platform) – *this criterion carried the most risk points*; and
 2. What the client discloses as being his/her business activity.
- All the clients that were **not** PEPs were usually classified as clients posing a normal risk.
- Clients referred to the firm by the foreign law firm were assessed as normal risk because the company had a policy of relying on the CDD carried out by the same;
- It later transpires that one of the company's international clients which was referred by a Eastern European law firm, is on that country's Ministry of Internal Affairs List for Embezzlement and Corruption. The accounting company is considering its options.



Case Study 2 (cont.)

What considerations should have been made by the accountancy firm?

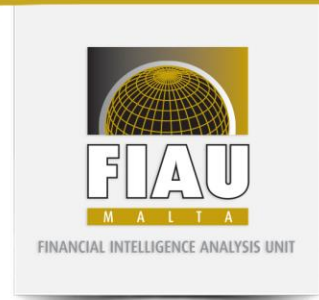
- Business growth should have been accompanied by the proportionate growth of internal ML/FT controls.
- The compliance personnel should have considered that the management's intention was purely to expand the business aggressively.
- The accounting company's decision for aggressive foreign expansion with firms who are seeking the same rapid expansion is another risk factor which should have been considered in the firm's risk assessment, since there is a likelihood that such firms will likewise put growth before compliance.
- The firm placed reliance on the law firms and assumed that all the clients referred to it were of normal risk, without first having assessed and evaluated their policies and procedures.



Case Study 2 (cont.)

What considerations should have been made by the firm's compliance personnel? (cont.)

- Dealings with foreign jurisdictions and individuals should have been factored into the risk assessment to:
 - (1) identify the risk to which the company is exposed to, and
 - (2) if the risk falls within the business' risk appetite, implement measures to manage that risk.
- The location of the law firms with which the accountancy firm partnered up: the jurisdictions may not have implemented the same or equivalent AML/CFT regimes.



Case Study 2 (cont.)

What AML/CFT mitigating measures should the accounting firm have implemented?

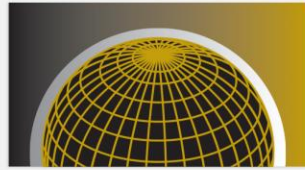
- It should have ensured the appointment of a competent compliance officer with sufficient knowledge of AML/CFT.
- A risk assessment should have been carried out prior to the business decision of overseas expansion, to assess the risks the firm would be facing following this decision.
- Prior to placing reliance on law firms' CDD measures, it should have assessed their policies and procedures.
- Where a higher risk rating is merited, EDD should have been applied on those clients.
- It should have adopted a more comprehensive risk scoring model which takes into account various risks factors (customer, geographical, service, and interface).

Case Study 2 (cont.)



Afterthoughts:

- The MLRO function cannot be taken lightly;
- Management should involve the compliance team to conduct a risk assessment and target mitigating measures accordingly;
- The compliance team and the MLRO should not allow themselves to be pressured by management to facilitate growth but they have a duty to ensure the implementation and adherence of compliance policies and procedures throughout.



FIAU

M A L T A

FINANCIAL INTELLIGENCE ANALYSIS UNIT

Yanika Pisani

yanika.pisani@fiumalta.org

65C, Tower Street, Birkirkara BKR 4012, Malta

T. (+356) 21 231 333 F. (+356) 21 231 090 E. info@fiumalta.org W. fiumalta.org
