AML Tuesday's Session #39/40 on:

Sectoral Risk Assessments for the Asset Management Sector and the Real Estate Sector

26 November 2024

Discussion Topics

01 Purpose and relevance of the SRAs

02 SRA process and sources, including examples of sector-specific sources

03 Aggregated STRIX results: sector-specific findings & comparisons between sectors

04 Next steps for the SRAs

01 Purpose and relevance of the SRA

FATF standards & Monaco's legal framework

Recommendation 1:

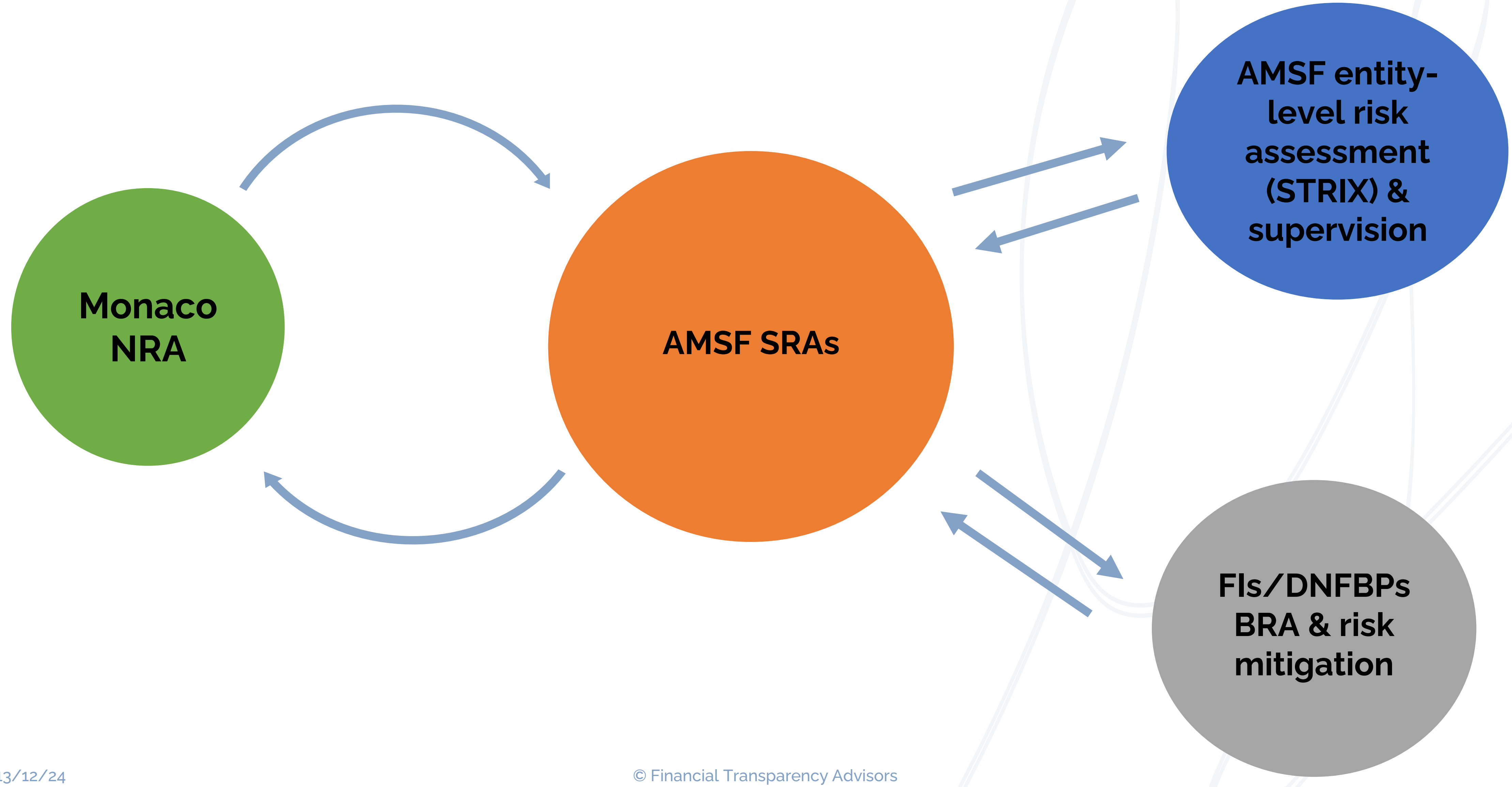
- ***Countries*** are required to identify, assess and understand the ML/TF risks to which they are exposed, and take effective action to mitigate these risks (see **Preliminary Article of Law No. 1.362**)
- ***FIs and DNFBPs*** should be required to take appropriate steps to identify, assess and understand their ML/TF risks and take measures to manage and mitigate them (see **Article 3 of Law 1.362**)

Recommendations 26 & 28:

- ***Supervisors*** should apply a risk-based approach to the supervision of AML/CFT compliance by FIs and DNFBPs (see **Article 56-1 of Law 1.362**)

Sectoral Risk Assessments conducted by supervisors are an important tool to help implement these recommendations, notably Recommendations 26 & 28, but also to inform risk assessments to be conducted under Recommendation 1.

Key functions of SRAs and links to other risk assessments



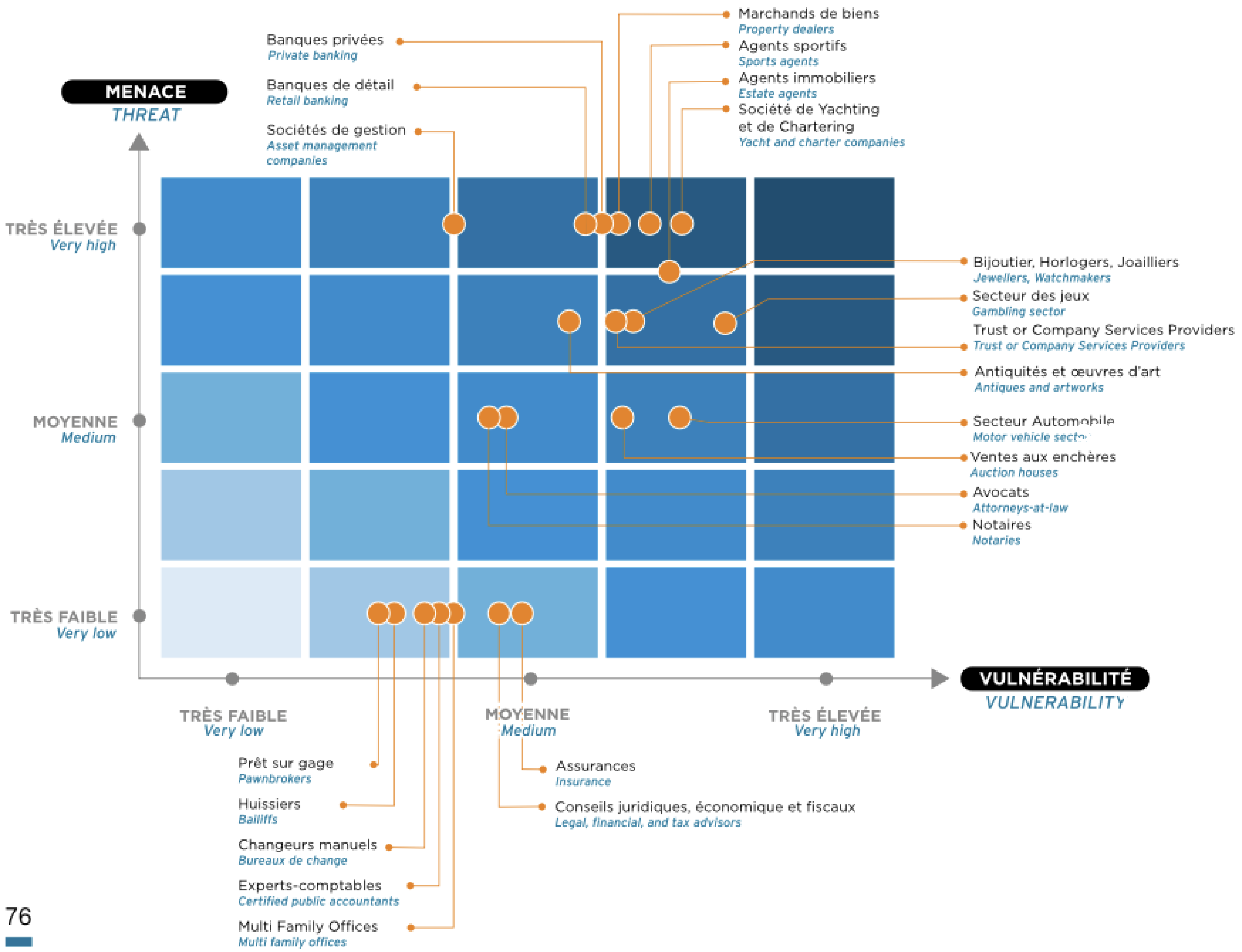
From FATF guidance on risk-based approach to supervision

- Understanding inherent risks and common weaknesses in AML/CFT controls at the sectoral level is the **starting point** for understanding risks at a more granular, i.e., entity-level. In order to achieve a comprehensive risk understanding, supervisors should **establish and maintain <u>ongoing</u> risk assessments of sectors** and individual entities and/or groups.

- Identifying risks particular to different sectors is essential for **prioritising supervisory activities** within the sector. In order to determine the risk of a sector as a whole, it is necessary to take into account the nature of the **business models** within the sector, as well as the business and **risk profiles** (e.g. volume of business, customer profiles) of the **entities in the sector**. It may also be useful to categorise entities in **sub-sectors** as a way to group together different types of risks

- **Aggregating ML/TF risk assessments of individual entities** (…) can help supervisors identify common ML/TF risks. At a sectoral level, entity-level risk assessments provide competent authorities with **important information on deficiencies in sector and national regimes**, allowing authorities to develop **appropriate responses** that may include publishing new regulations or amending existing ones, applying enhanced measures, and issuing supervisory guidance.

Monaco - Sectoral risk distribution in NRA 2 (2021)



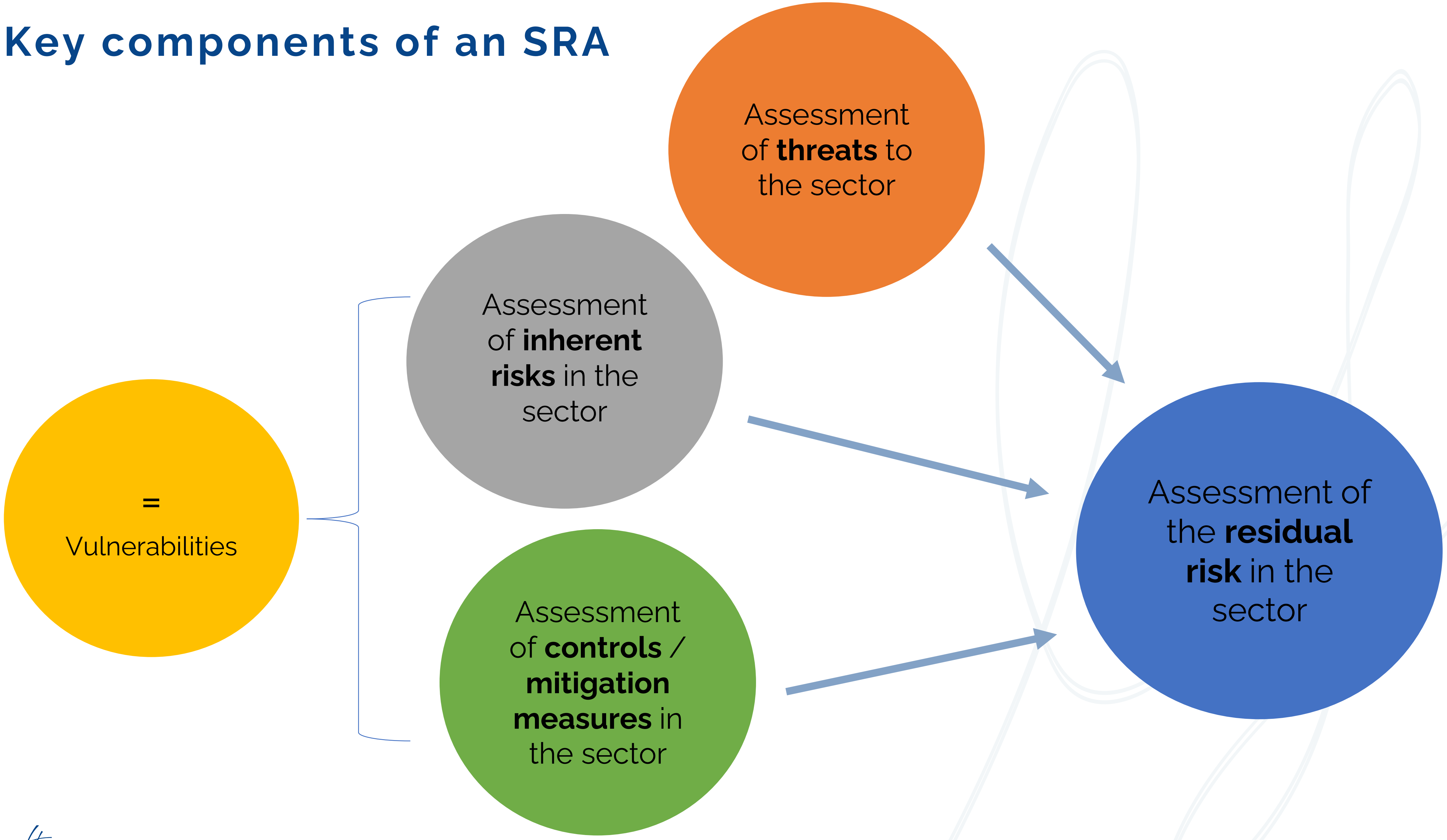
SRAs since NRA 2

- AMSF conducted two SRAs in 2023 to follow up on MONEYVAL's 2022 recommendations for deepening the risk assessment for certain sectors (**TCSPs/trustees** & **casino sector**).
- In 2024, AMSF is undertaking SRAs of three medium-high to high-risk sectors:
  - **Banking sector**
  - **Asset management sector**
  - **Real estate sector**
- In 2025, AMSF may select further sectors for SRAs, on a risk-sensitive basis.

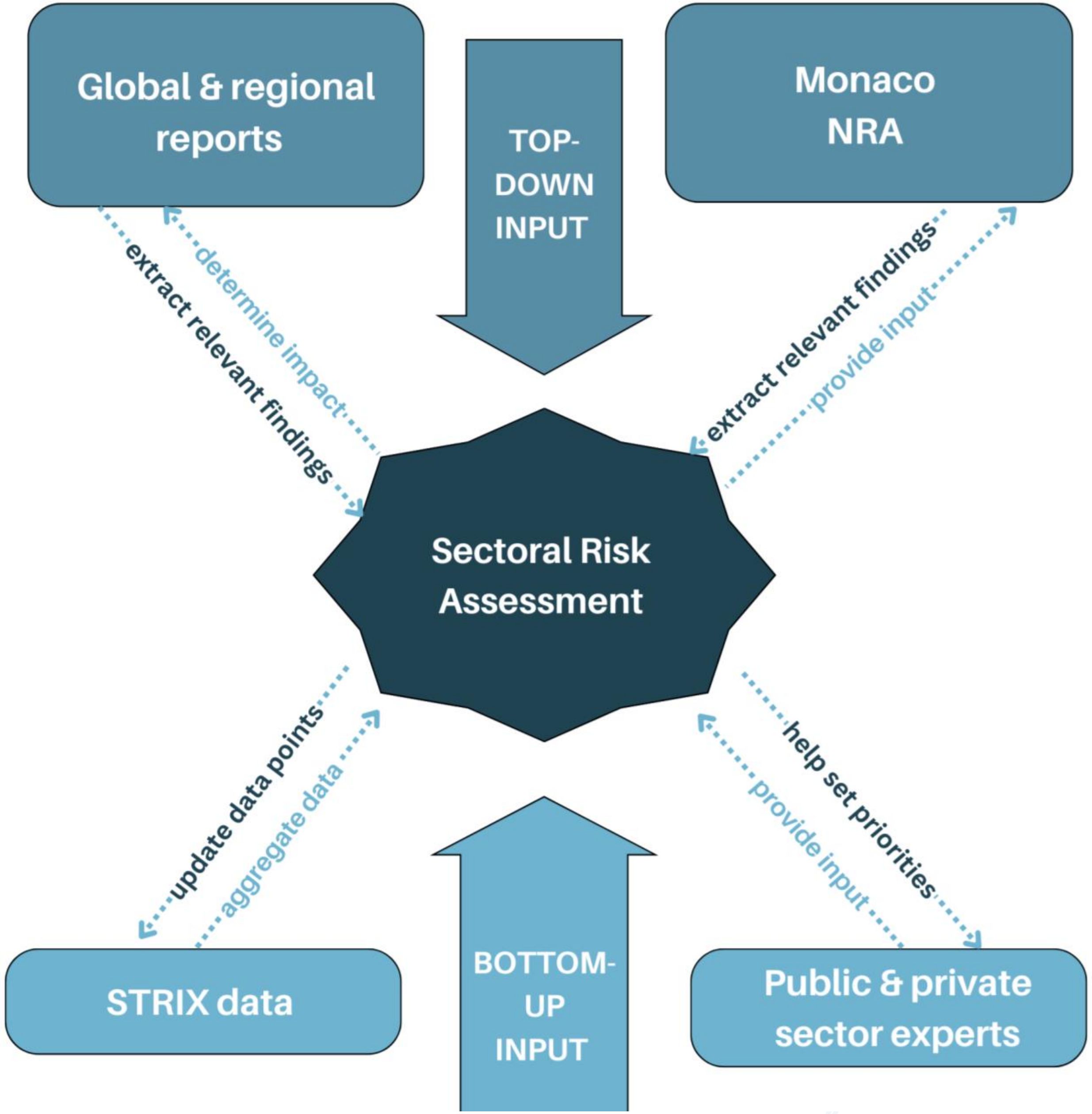
→ Choice/prioritisation of sectors for which SRAs are carried out is informed by several factors, including NRA results and planning, inspection findings, new and emerging risks

02 SRA approach and sources

Key components of an SRA



Overall approach to the assessment of sectoral risks



National-level risk assessments

NRA 2	Legal persons TRA	NPO TRA	Virtual Assets TRA
ML Threat Assessment	TF NRA	PF TRA	Foreign tax evasion TRA

Public and private sector expertise

Financial intelligence	Law enforcement information	Insights from international & national cooperation
AMSF findings of inspections and meetings	Private sector round-tables	Data on breaches and enforcement

Global and regional reports – main sources

FATF	Egmont Group	Interpol	OECD
European Commission (sNRA)	EBA	Europol	SRAs of home supervisors of financial groups

Example for asset management sector: EBA report

The EBA's fourth Opinion on ML/TF risks affecting the EU's financial sector, accompanied by a detailed Report (= SRA at EU-level), of July 2023 (covering data from EU supervisors from January 2020– January 2023) covers **three different sub-sectors within the asset management sector.**

For all three sub-sectors, the majority of the CAs assess their inherent risk profiles as "moderately significant" (2 on a scale of 1 (less significant) to 4 (very significant)) and the overall quality of controls as "good" (3 on a scale of 1 (very poor) to 4 (very good)), resulting in **moderately significant residual risks.**

For each sub-sector, there are important differences in the factors leading to the rating as well as specific observations and challenges to be aware of.

1. Investment firms
2. Collective investment undertakings
3. Fund managers

2023 EBA Report

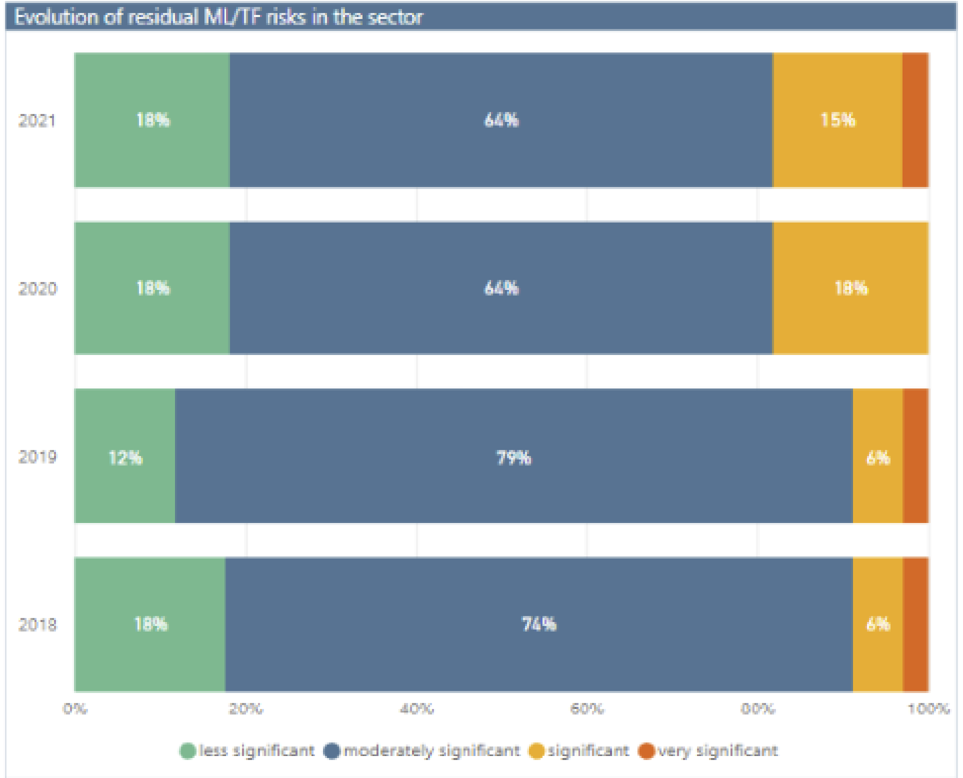
1 Investment firms

A key inherent risk flagged by EBA is the sub-sector's **significant exposure to tax-related crimes:**

*"Investments firms are often exposed to significant risks related to tax-related crime. This is especially the case when customers are **repatriating funds from abroad (tax havens)** and when investment firms do not have access to adequate know-how to identify and assess the source of wealth and funds and to **make sure that related tax obligations have always been respected in the past, both regarding the wealth and the related income."***

The proportion of CAs assessing residual risks as significant has increased over the last years – see figure. Cited reasons include increased **geographic risks** (links to high-risk countries), increased **customer risk** exposure (HNWIs, non-residents) and observed **threats/ typologies** such as mirror trading, and misuse of money accounts tied with securities accounts.

Figure 41: Evolution of residual risk profile in the sector of investment firms since 2018



2023 EBA Report

2 Collective investment undertakings

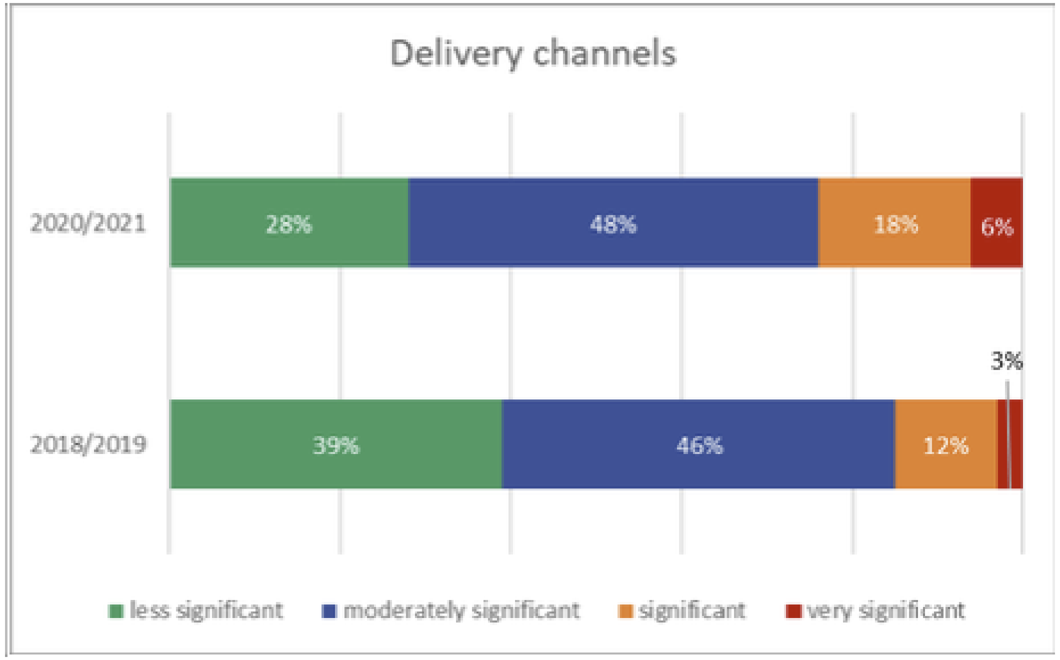
Most CAs consider customer and geographic risks to be key for the sub-sector, but part of them also flag **rising, significant delivery channel risks:**

*“24% of CAs assess risks associated with delivery channels as (very) high with a **distribution of fund units through intermediaries**, and the **reliance on data** provided by intermediaries”*

These intermediaries are often in other jurisdictions, leading to (very) significant **cross-border risks** of delivery channels.

As to product risks, the sector offers a wide variety of **complex products**, such as hedge funds, SICAVs, funds with international participations in other financial products, omnibus account services, private investor funds and private funds similar to asset protection vehicles.

Emerging risk: some funds also offer investments in **crypto-assets.**



2023 EBA Report

3 Fund managers

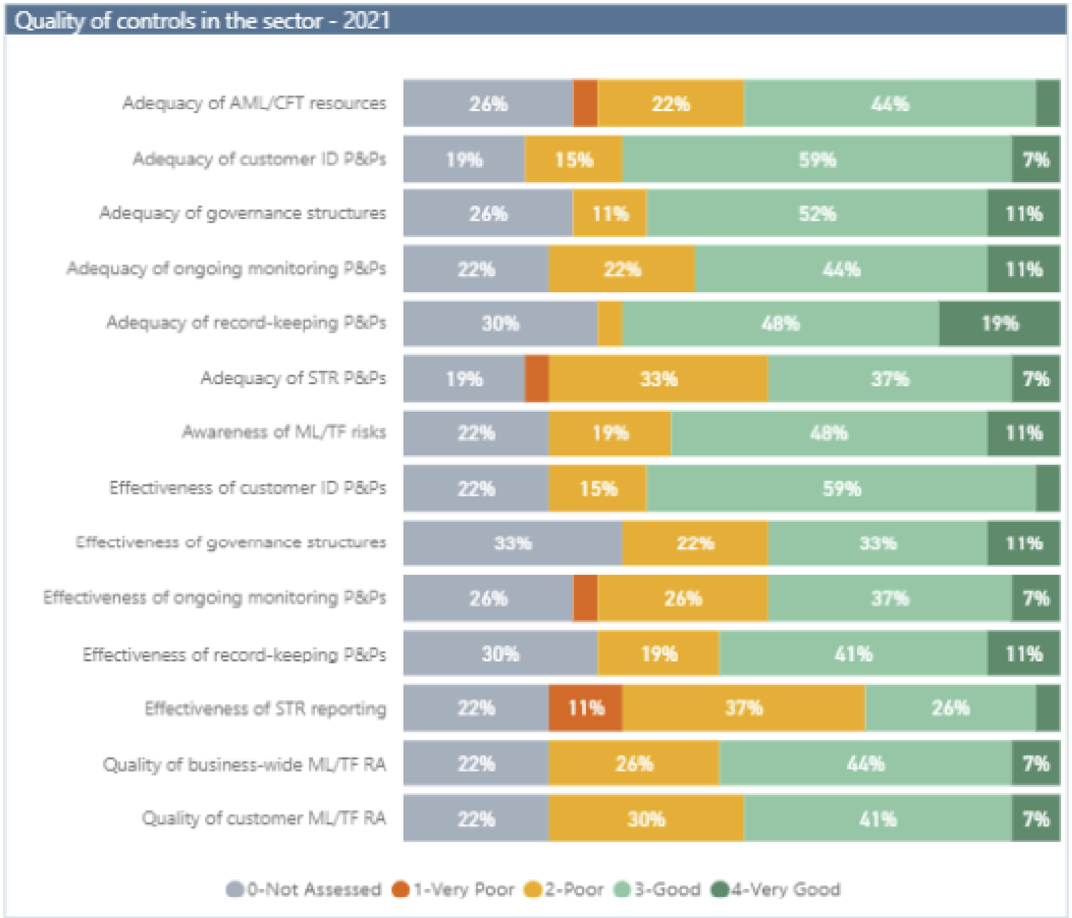
*"The sector may be abused to launder the proceeds resulting from criminal activity such as **tax evasion, bribery, corruption and organised crime**. CAs mentioned that **some STRs from the sector reflect those trends,** even if reporting rate remains low."*

Some CAs noted particular risks related to the links of the sub-sector to **citizenship- and residence-by-investment schemes** (see also 2023 FATF/OECD report & AML Tuesdays webinar #27 on STR Typologies).

Commonly noted challenges/gaps in controls for the sub-sector:

- Ongoing difficulties by firms in **identifying PEPs** or establishing the **BOs of customers**;
- **Risks of conflict of interests** that prevent an independent and adequate management of ML/TF risks related where investors are also shareholders or owners of investment products.
- **Frequent outsourcing** of AML/CFT activities to third party service providers which requires robust oversight and assurance testing programmes to be implemented.
- **Poor STR** policies and procedures and effectiveness of reporting.

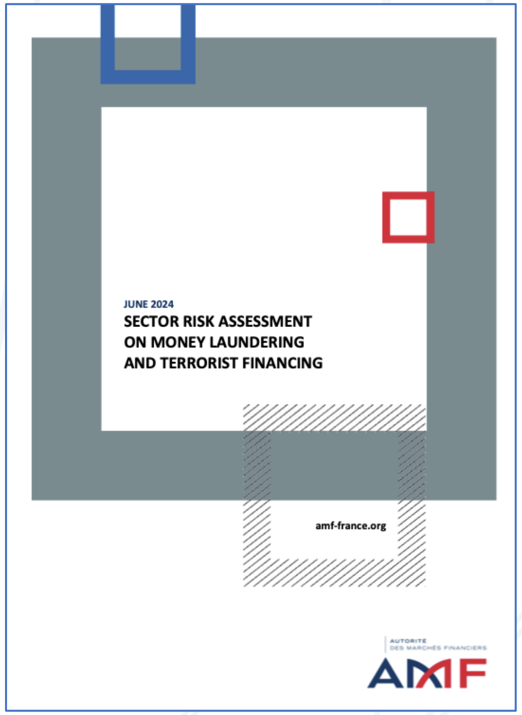
Figure 52: Competent authorities' assessment of the quality of the controls in place in the sector of fund managers



Example for AM sector: SRAs of home supervisors

Sectoral **customer risks** flagged by home/group supervisors (AMF, FINMA):

- Use of complex structures: structures whose complex design leads to a **lack of transparency about the beneficial ownership** of assets but also a **web of business relationships**, where the use of **multiple domiciliary companies** makes it impossible to establish the **economic purpose**, can also be used to conceal the origins of criminal assets.
- **Demanding clientele**, often **represented by third parties or business introducers**, which may be more **reluctant to respond** to all requests for supporting documents.
- PEPs or foreign tax residents may be based in **countries with inadequate AML/CTF legislation.**
- **New/emerging risk:** Large number of **new customers** of wealth management industry are to be found in **emerging markets**, where there is a **significant threat of corruption**. The financial flows of corruption involve not just PEPs, but also **state or quasi-state organisations and sovereign wealth funds**



Example for real estate sector: EC's sNRA

- The EU AML Directive mandates the European Commission to conduct an assessment of specific ML/TF risks affecting the internal market and relating to cross-border activities. The most recent **EU supra-national risk assessments (sNRAs)** dates from 2022.
- The sNRAs include ratings of ML and TF Threats and Vulnerabilities, and residual Risk, for a wide range of financial and non-financial sectors, including the **real estate sector.**
- To prepare the **2022 sNRA,** the Commission carried out a **broad consultation exercise between 2020 and 2022** involving many relevant stakeholders and various sectors through bilateral and **sectoral dialogue** with representative organisations at EU level, national-designated experts and academia, including the **European Association of Real Estate Professions (CEPI)** and **Notaires d'Europe.** The Commission also consulted other EU agencies and national authorities, such as Europol, the EBA and FIUs through the EU FIU Platform. The Commission further took into account NRAs produced by the Member States and specialized AML/CFT publications.

EC's 2022 sNRA - conclusions on risks to RE sector

EC's 2022 sNRA concludes that the real estate sector is exposed to **very high ML risks**, on account of **very significant ML threats**, based on the strong evidence gathered by LEAs that real estate is frequently used in ML schemes, combined with **very significant ML vulnerabilities**, i.a. due to:

- The involvement of different kinds of obliged entities in a real estate transaction tending to dissuade the sector from conducting its own CDD
- Suspicious transaction reporting is not satisfactory
- The sector is reported not to be organised well enough to sufficiently raise risk awareness
- Checks are difficult to carry out and there is not always a sound information trail.

While the sNRA focused on the EU real estate market, it also considers **cross-border risks:**

→ One of the sources for the assessment is a 2021 specialised study commissioned by the EC in the context of the fight against tax evasion, on the **amount of wealth hidden by EU individuals in IFCs**

→ This study aimed to provide a first estimation as to the magnitude of offshore wealth that EU residents store in cash, life insurance and real estate.

→ The study arrives at an estimation of **EUR 1.3 trillion for offshore real estate**, part of which is reported to be related to **tax evasion by EU (U)HNWIs**, who use real estate as a vehicle to conceal wealth, normally **through legal entities** that hide the identity of the beneficial owner.

STRIX data

- Since the time of the SRAs conducted for NRA 2, AMSF has significantly strengthened its **information position on risks** thanks to the implementation of STRIX survey process
- SRA uses data from **2023 STRIX return** (covering 2022 reporting period) and **2024 STRIX return** (covering 2023 reporting period)
- STRIX covers **inherent risks** (structural, customers, products/services/transactions, distribution channels, geographic risks) as well as **scored controls** (based on self-reporting by sectors) and **assessed controls** (based on supervisory findings)
- STRIX allows for various ways to deploy data for SRA, including:
  - Aggregating entity-level data on risk indicators and controls
  - Grouping of data per sub-sector
  - Monitoring trends and developments (2022 versus 2023)
  - Comparisons with other sectors on cross-sectoral risk indicators (e.g. exposure to PEPs)
  - Assessing sector-specific risks through sector-specific indicators
  - Comparing scored controls with assessed controls

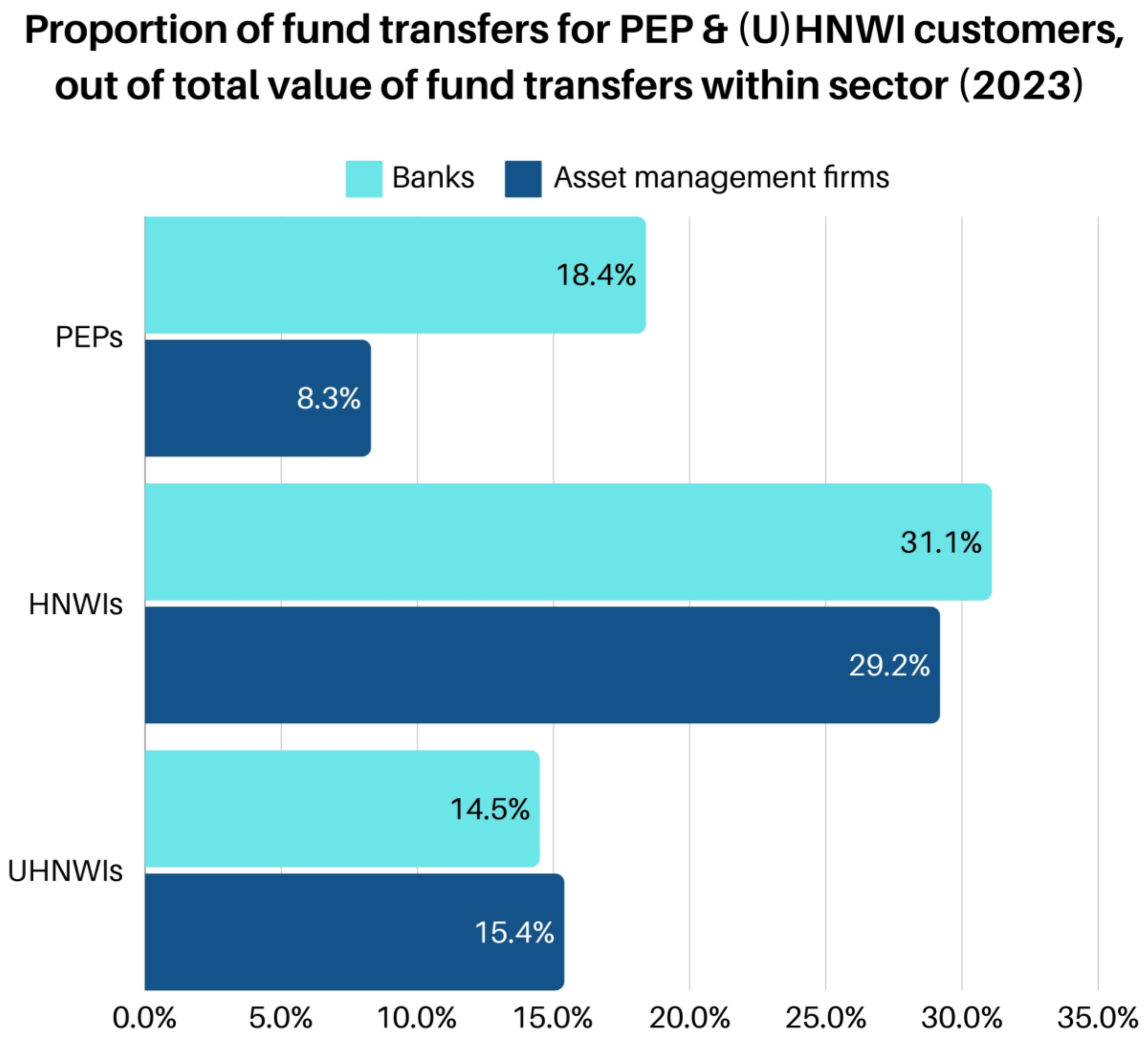
03

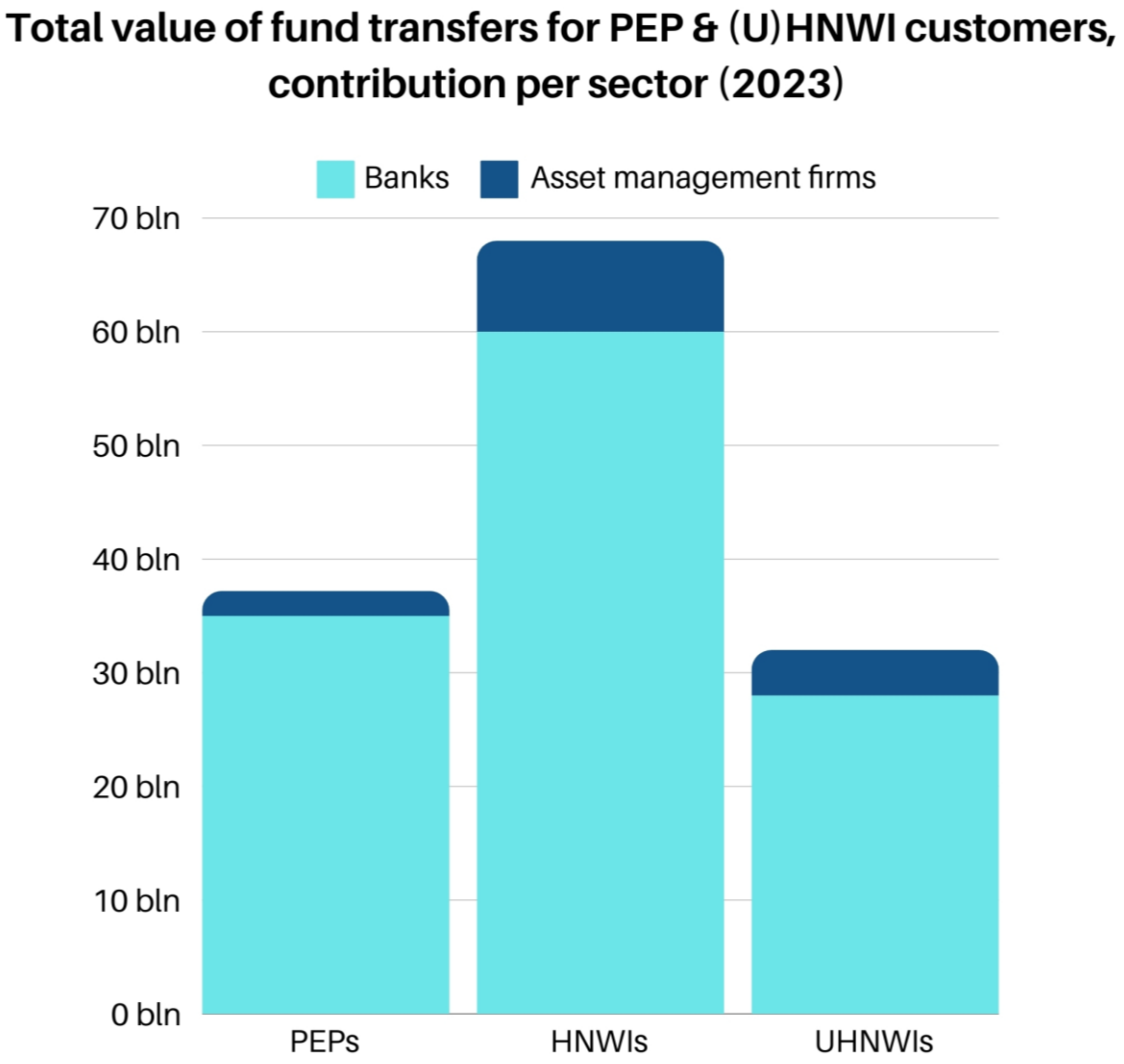
Aggregated STRIX results

Overall feedback on STRIX returns

- >95% response rate to STRIX survey by both sectors, demonstrating the **strong and growing commitment** of the sectors to AML/CFT compliance and good cooperation with the supervisor
- Data quality overall relatively good and some positive developments noted for second STRIX survey compared to first STRIX survey
- Significant room for improvement remains for many firms in both sectors, in particular in relation to the quality of data reporting on **customer risk indicators, including in relation to PEPs, HNWIs & BOs**
- A few outliers remain – a few firms do not report (sufficient) data or data appears not fully reliable. AMSF will follow up where needed.

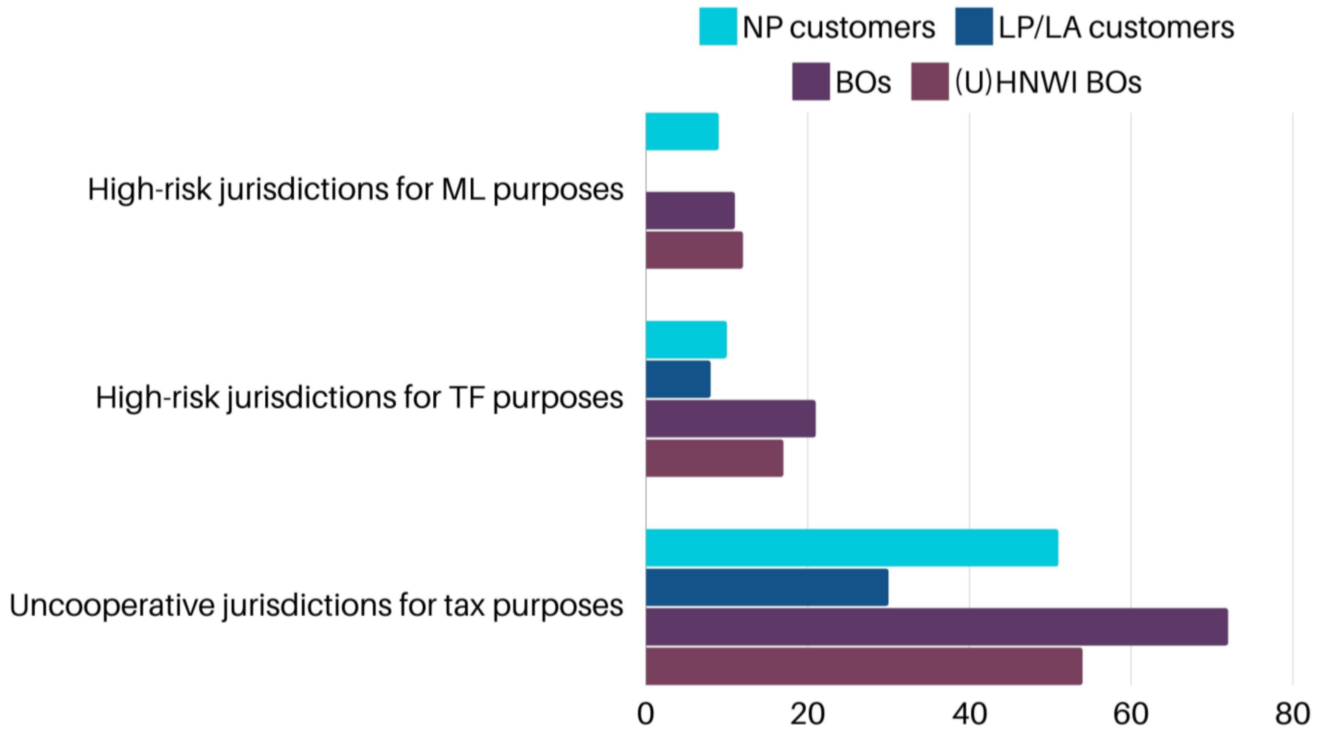
Inherent risks – highlighted findings for customer risks (AM)



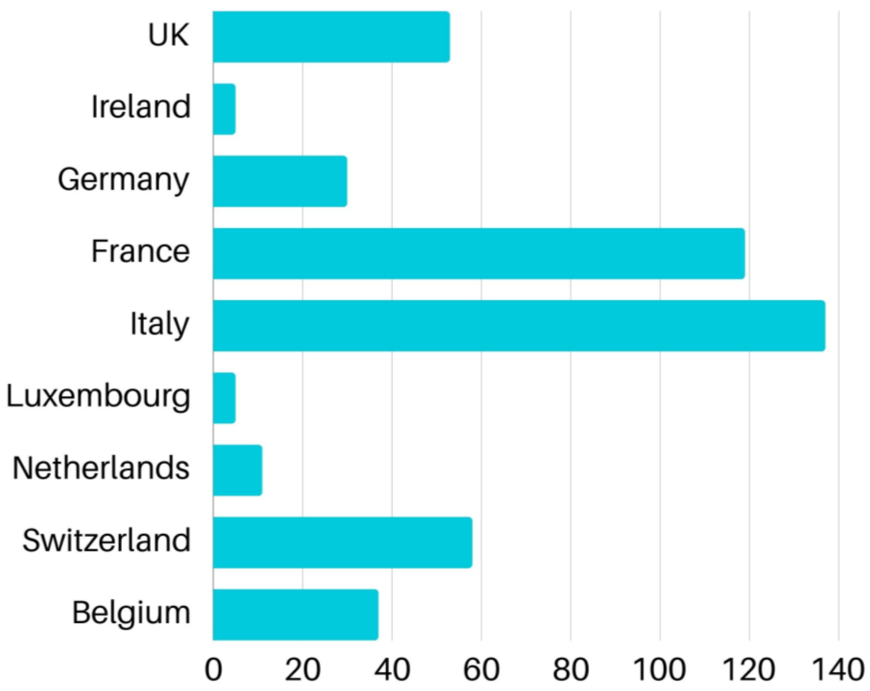


Inherent risks – highlighted findings for customer risks (RE)

Prevalence of high-risk jurisdictions among different customer categories (2023)



Prevalence of customers & BOs from European jurisdictions with high level of personal income tax evasion in absolute volume of funds evaded (2023)



Inherent risks – highlighted findings for customer risks (AM & RE)

STRIX returns point at some (serious) **gaps in both asset management sector and real estate sector** in relation to the **assessment of customer risk exposure**, including risks relating to beneficial owners and risks which are highly relevant for Monaco's context (PEPs, HNWIs):

66% of AMs and **82%** of REAs state that they do not have any **PEP** clients.

37% of AMs state that they do not have any **HNWI** clients. **25%** of REAs does not distinguish whether customers are HNWIs.

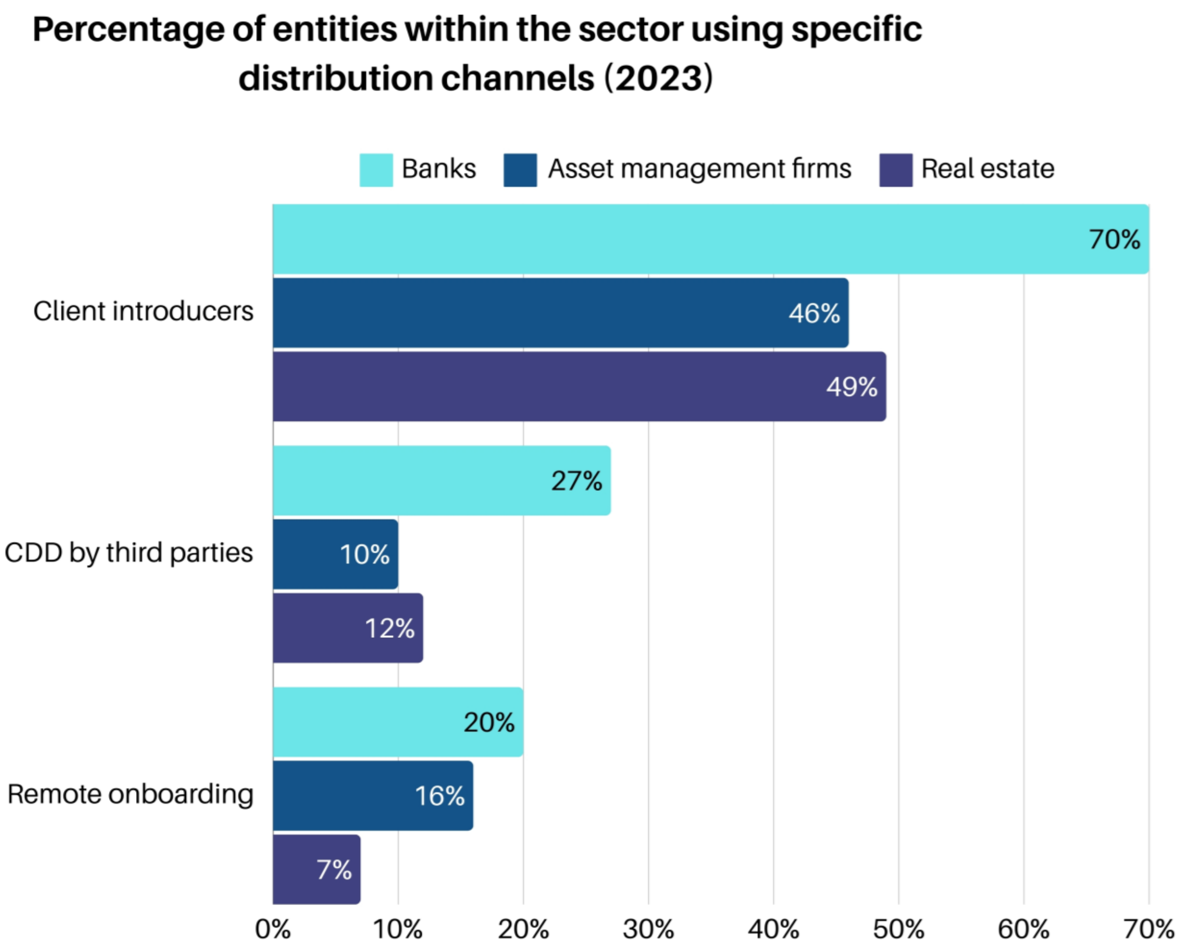
56% of AMs and **40%** of REAs does not record all **nationalities** of clients/BOs

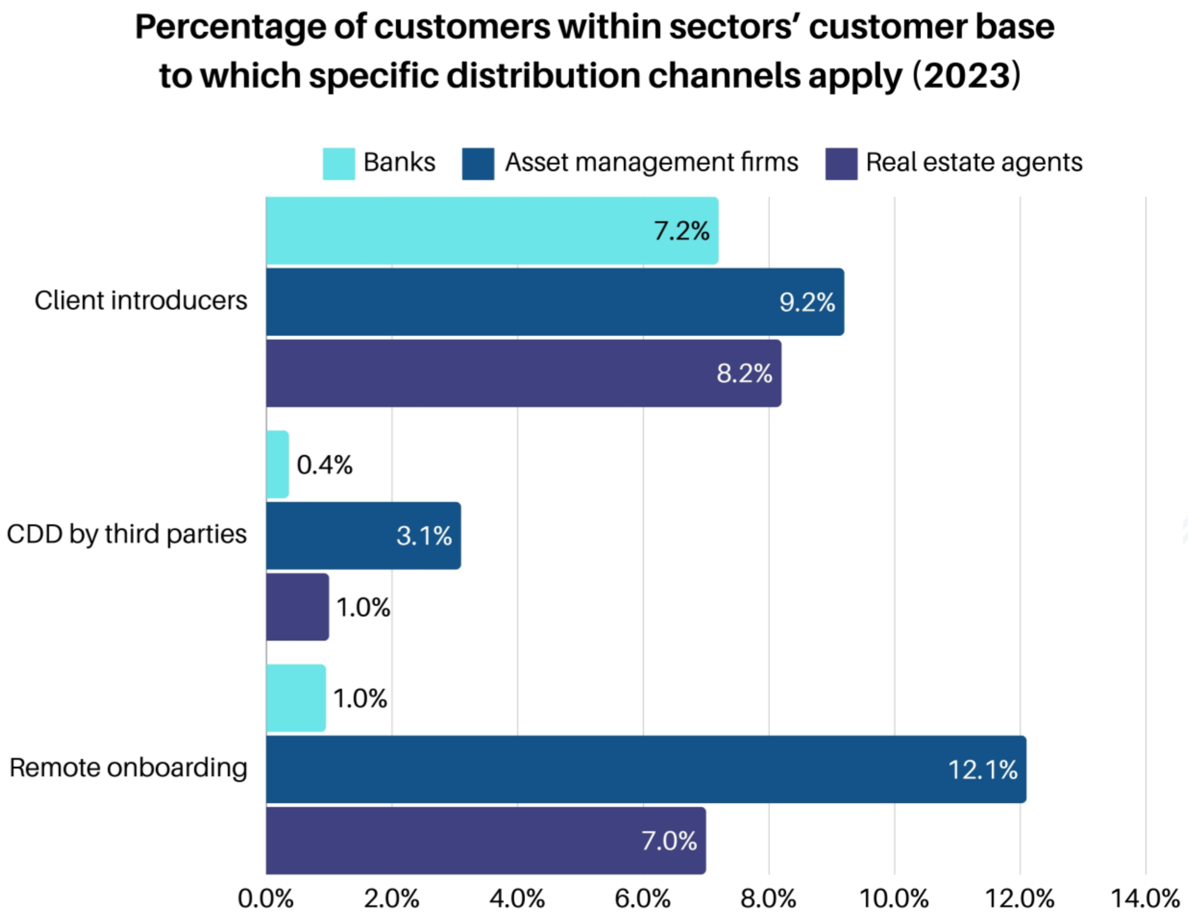
24% of AMs and **43%** of REAs does not distinguish whether customers are VASPs

10% of AMs and **20%** of REAs does not distinguish whether customers are associations, trusts of other legal arrangements.

16% of AMs and **8%** of REAs does not distinguish the **nationality of BOs** at all

Inherent risks – highlighted findings for distribution risks (AM & RE)

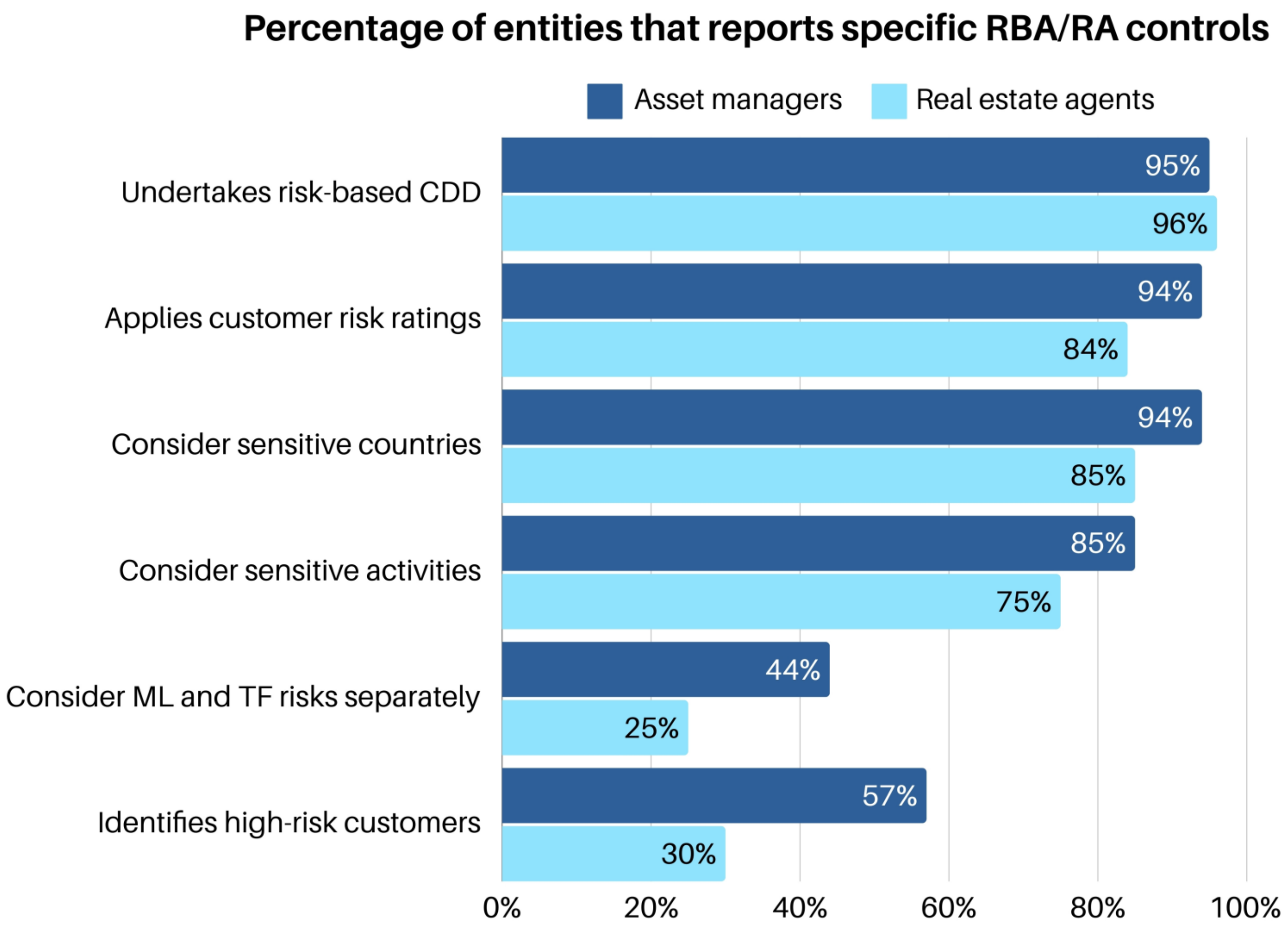




Cross-border risks: third parties introducing clients are frequently foreign, and mostly from outside of the EEA, including a substantial part from higher-risk jurisdictions (cf. concerns expressed in 2023 EBA Report).

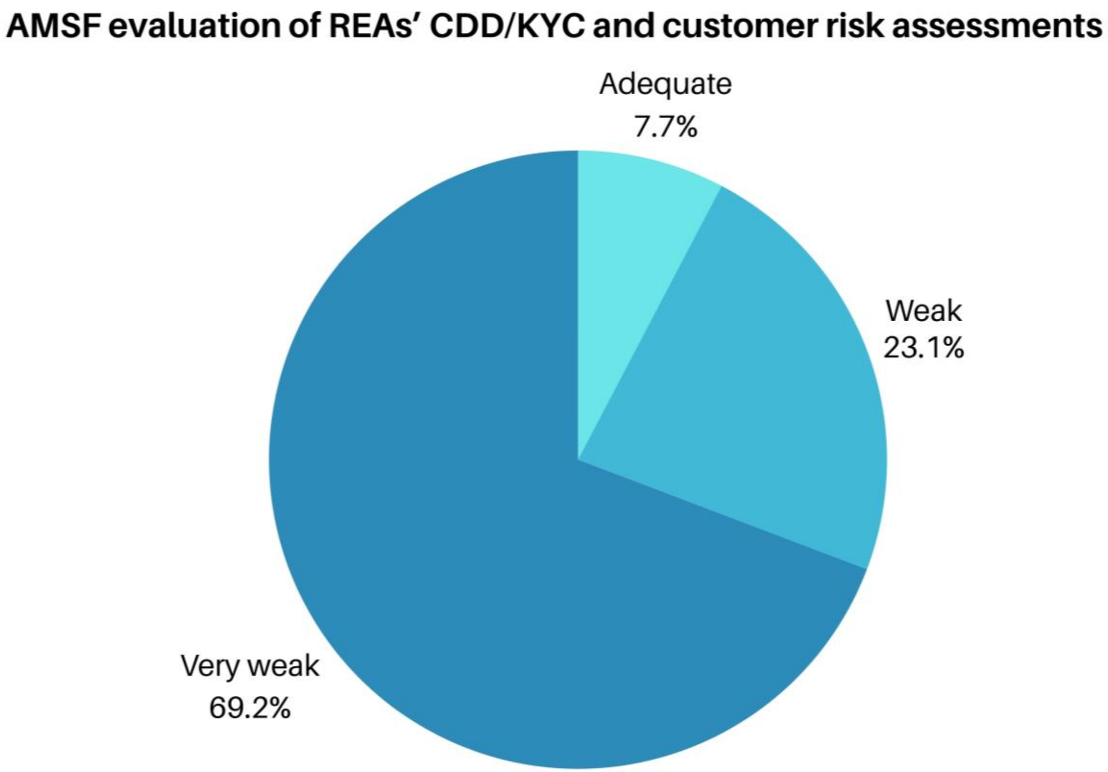
Controls – highlighted findings on BRA & RBA to CDD (AM & RE)

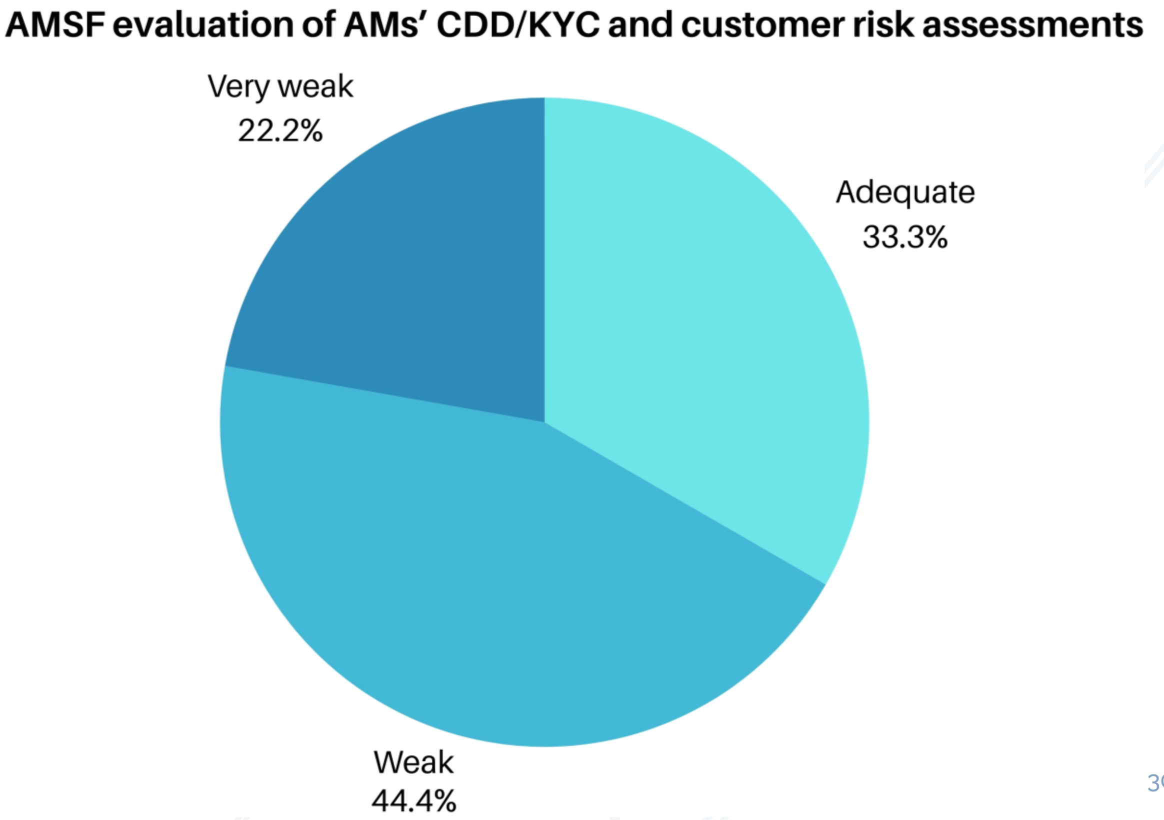
- As per **NRA 2 results,** the risk-based approach was not sufficiently applied by asset management companies and by real estate professionals.
- Some progress is noted as per the sectors' **scored controls** (based on self-reporting); however, room for improvement still remains and results on some of the control indicators are still concerning – see graph with STRIX results



Controls – highlighted findings on BRA & RBA to CDD (AM & RE)

- **Evaluated controls scores** for BRA and risk-based CDD/ CRA – based on AMSF inspections until mid-2024– show mixed results across both sectors:
  - For **BRA,** majority of inspected AMs & REAs is assessed as having **adequate** controls
  - For **CDD/CRA,** majority of inspected AMs & REAs is assessed as having **(very) weak** controls. with relatively better results in the AM sector – see charts





Controls - highlighted findings on monitoring and STRs (AM & RE)

- From **NRA 2**: "The majority of asset management companies do not have an automated system to **monitor transactions**. In the absence of such a system, an internal transaction monitoring system is not systematically used, despite this being a regulatory requirement [see Art. 28 of SO 2.318]"
- <u>No substantial improvements</u> are noted in this respect in the AM sector through the **STRIX** returns:
  - As of 2023, the majority (55%) of firms still does not have an automated system
  - 79% of firms does not report any ML alerts generated by monitoring activity
  - Very low number of TF alerts generated by monitoring activity across whole sector
  - No blocked or rejected transactions due to ML/TF/PF concerns across whole sector
- Overall, still low numbers and no strong increases yet in the **reporting of STRs** in both asset management and real estate sectors, although with some <u>careful positive trends</u>:
  - Only 14% of AM firms filed an STR in whole of 2020-2022 period versus 10% of firms has filed an STR in 2023 and the numbers of STRs per year filed by the sector are increasing
  - 11% of REAs filed an STR in whole of 2020-2022 period versus 11% of REAs has filed an STR in 2023; and the numbers of STRs per year filed by the sector are increasing

04 Next steps for the SRAs

Planning for finalization of 2024 SRAs

- **December 2024**:
  - Roundtables with private sector representatives in order to exchange views on sectoral risks and collect qualitative input from the private sector in addition to the quantitative input provided through STRIX
  - Invitations are organised through the sector associations
- **Early 2025**:
  - Finalisation of the SRAs
  - Sharing of results with public sector (domestic & international) stakeholders in AML/CFT field on need-to-know basis
  - Communication of final results to private sector

Follow-up to SRAs

- **Public sector follow-up actions -** Results of the SRAs will inform:
  - Selection of entities for full-scope inspections and thematic inspections, including selection of themes/areas of higher focus for upcoming years
  - Use of inspections to validate main findings from STRIX surveys
  - Determination of need to amend/update STRIX surveys & instructions for next cycles
  - Determination of areas of increased attention in the monitoring of results of next STRIX rounds
  - Selection of priorities for guidance and outreach activities
  - Next iteration of the NRA
  - Maintaining up-to-date sectorial risk understanding, e.g. upon publication of next EU sNRA
- **Private sector follow-up actions –** Results of the SRAs should inform:
  - Decisions on resourcing
  - Selection of themes for further training and internal awareness-raising activities
  - Update of the BRA: review BRA in light of SRA findings
  - Review of the CRA methodology: is there a need to introduce new risk factors?
  - Review of transactions and customers: is there a need to add/amend transactions monitoring systems and/or to conduct ad-hoc reviews of certain customer groups/transactions?
  - Review of controls: which controls should be further strengthened to address risks?

Thank you for your time

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Next Session:

10.12.2024

Topic:

Sector Specific New AMSF Guidance for FIs

Today's Host: Margaux Berland

Today's Presenter: Suzanna van Es