AML Tuesday's Session #38 on:

Sectoral Risk Assessment for the Banking Sector

12 November 2024

Discussion Topics

01 Purpose and relevance of the SRA

02 SRA process and sources

03 Aggregated STRIX results

04 Next steps for the SRA

01 Purpose and relevance of the SRA

FATF standards & Monaco's legal framework

Recommendation 1:

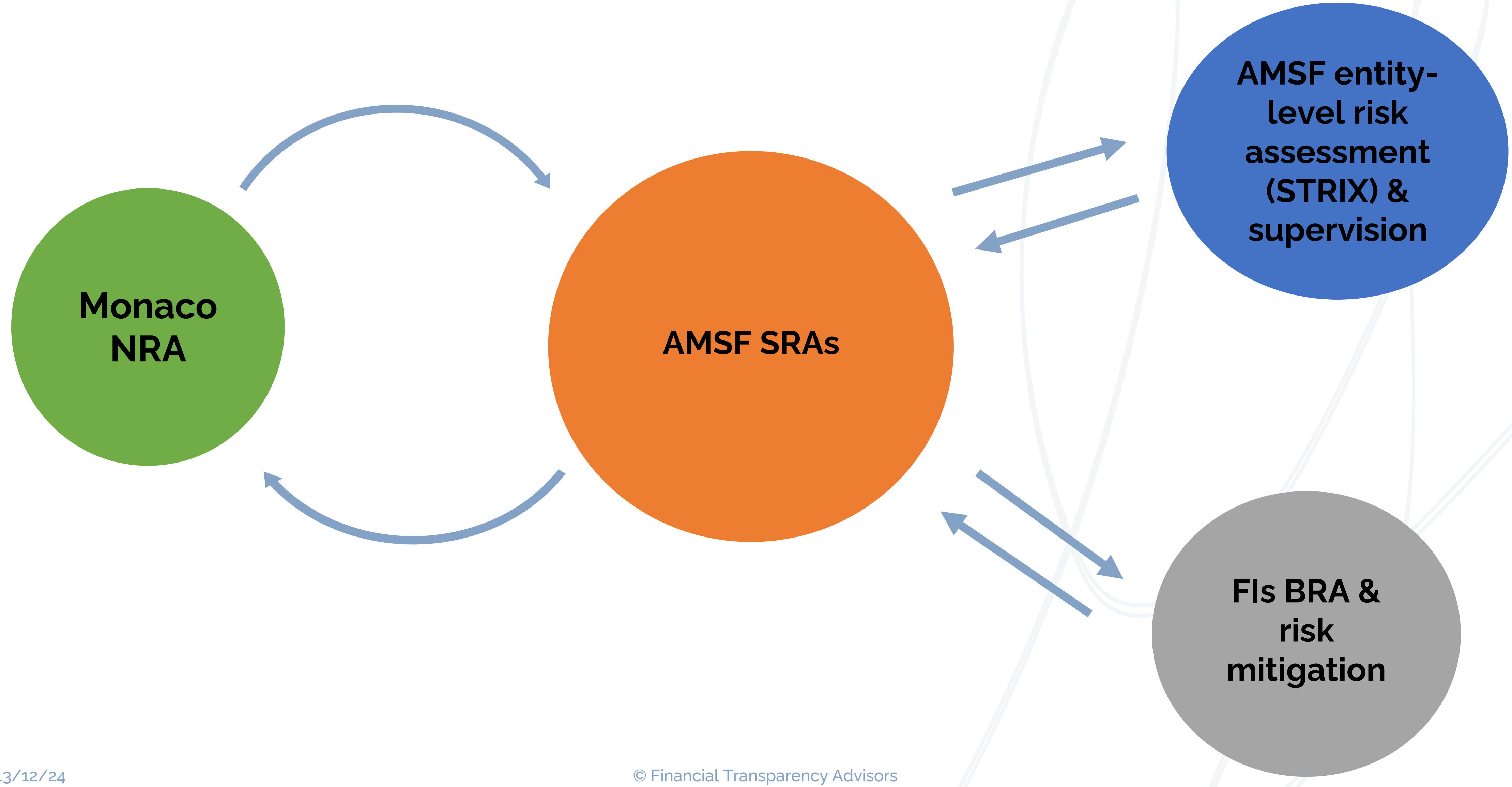
- ***Countries*** are required to identify, assess and understand the ML/TF risks to which they are exposed, and take effective action to mitigate these risks (see **Preliminary Article of Law No. 1.362**)
- ***FIs and DNFBPs*** should be required to take appropriate steps to identify, assess and understand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

Recommendations 26 & 28:

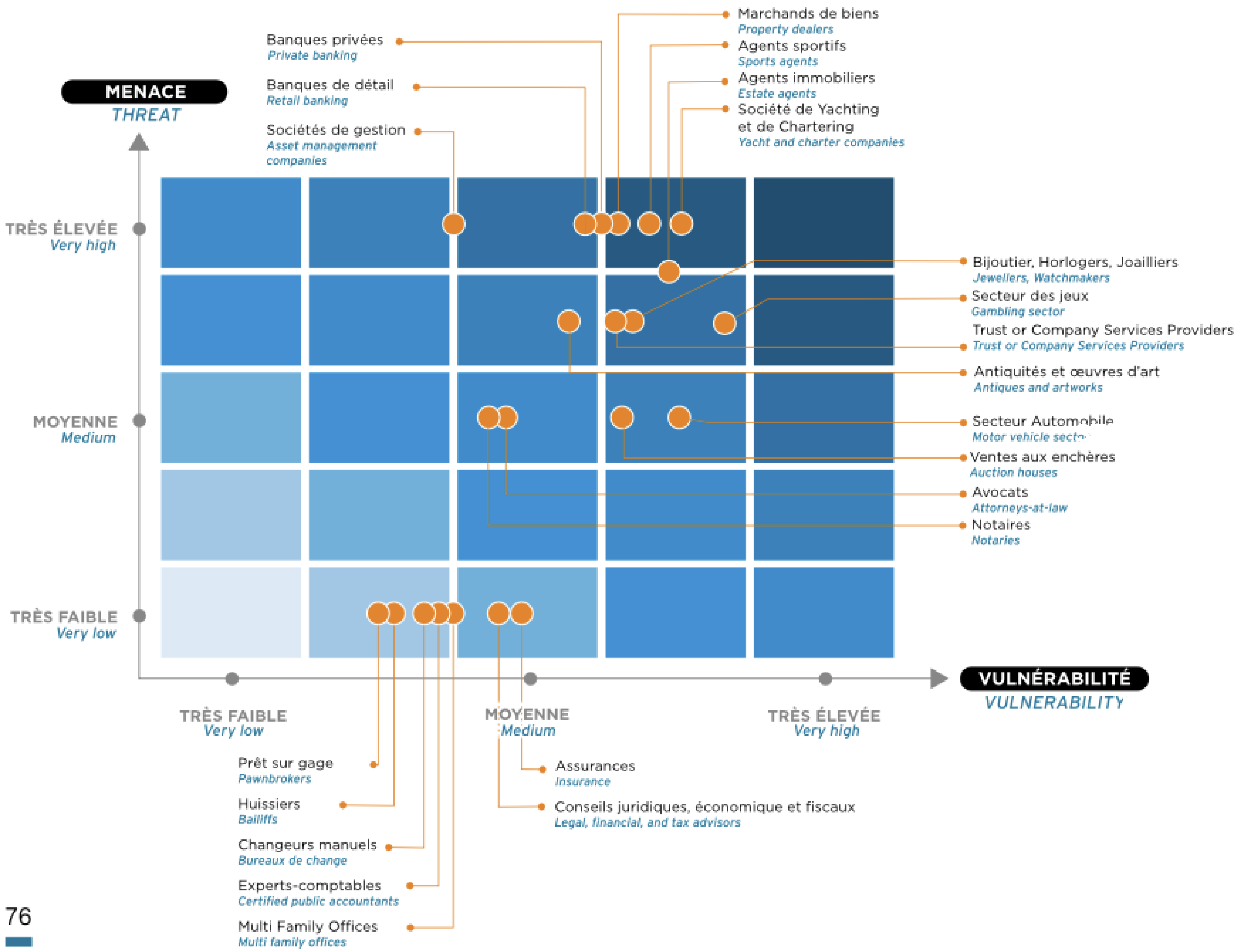
- ***Supervisors*** should apply a risk-based approach to the supervision of AML/CFT compliance by FIs and DNFBPs (see **Article 56-1 of Law 1.362**)

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



Monaco - Sectoral risk distribution in NRA 2 (2021)



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.

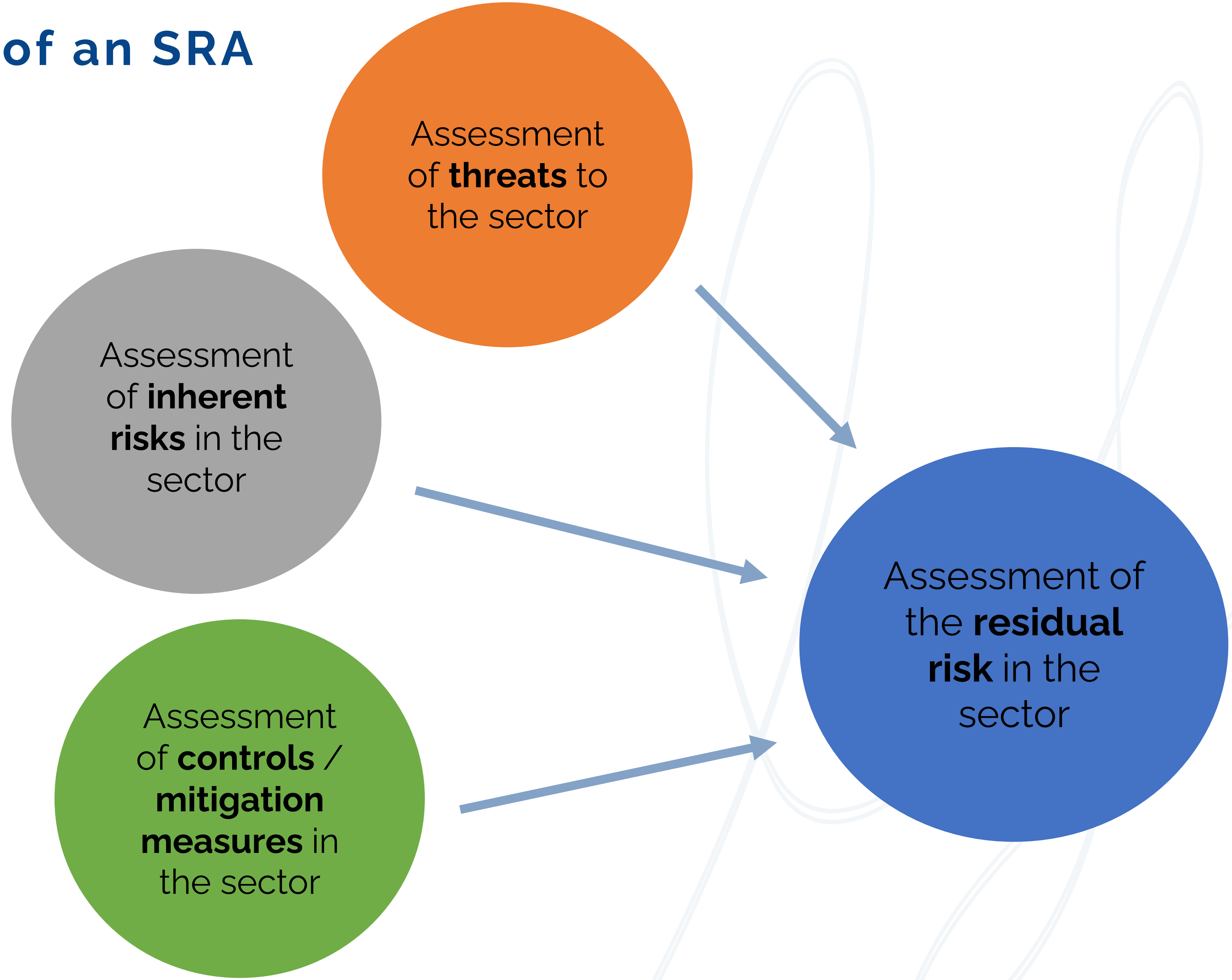
02 SRA process, approach and sources

SRA process

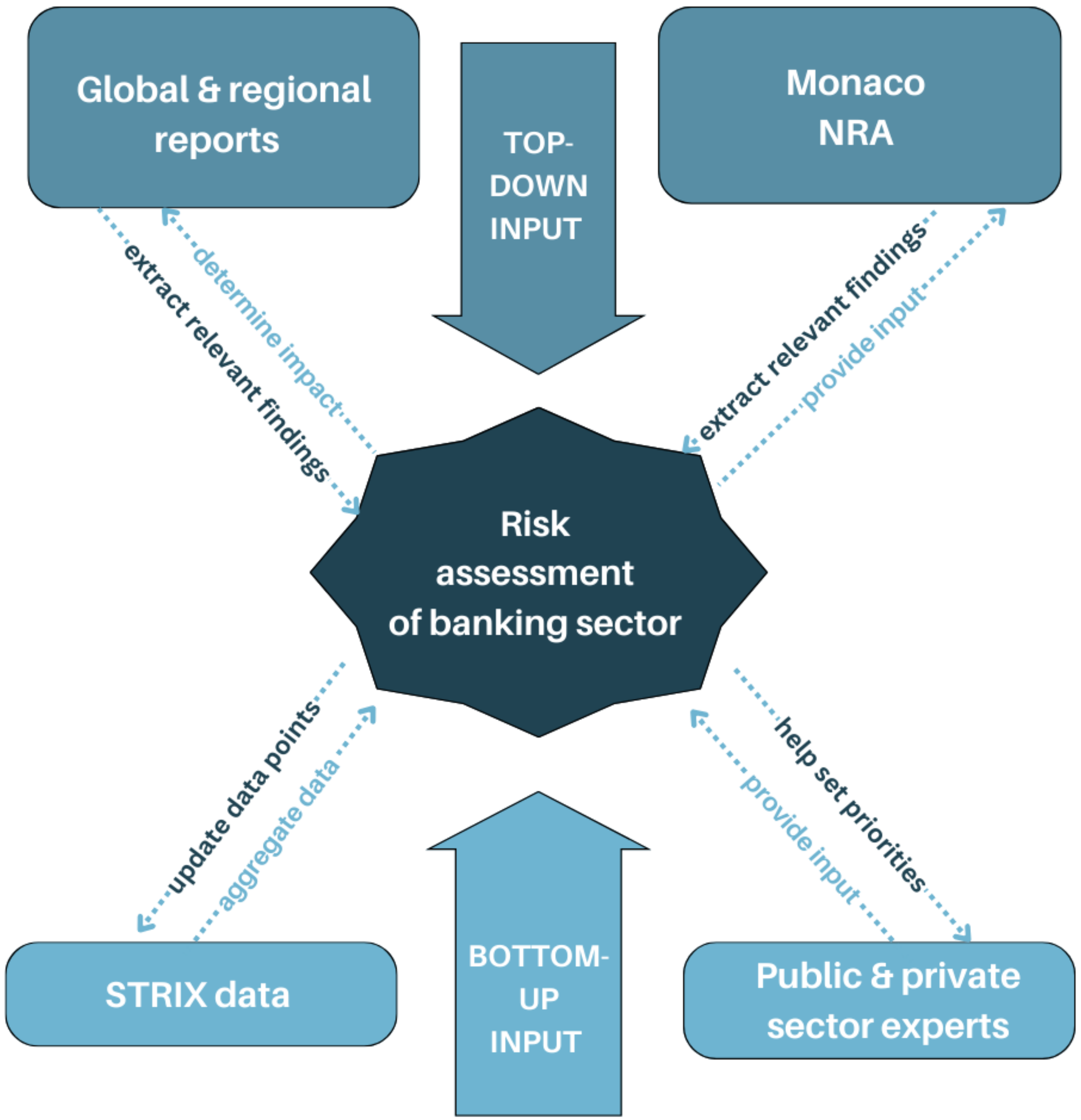
- AMSF conducted two SRAs in 2023 to follow up on MONEYVAL's 2022 recommendations for deepening the risk assessment for certain sectors (**TCSPs/trustees** & **casino sector**).
- In 2024, AMSF is updating SRAs of three medium-high to high-risk sectors:
  - **Banking sector**
  - **Asset management sector**
  - **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/updated is informed by several factors, including NRA results and planning, inspection findings, monitoring of new and emerging risks

Key components of an SRA



Overall approach to the assessment of sectoral risks in the banking sector



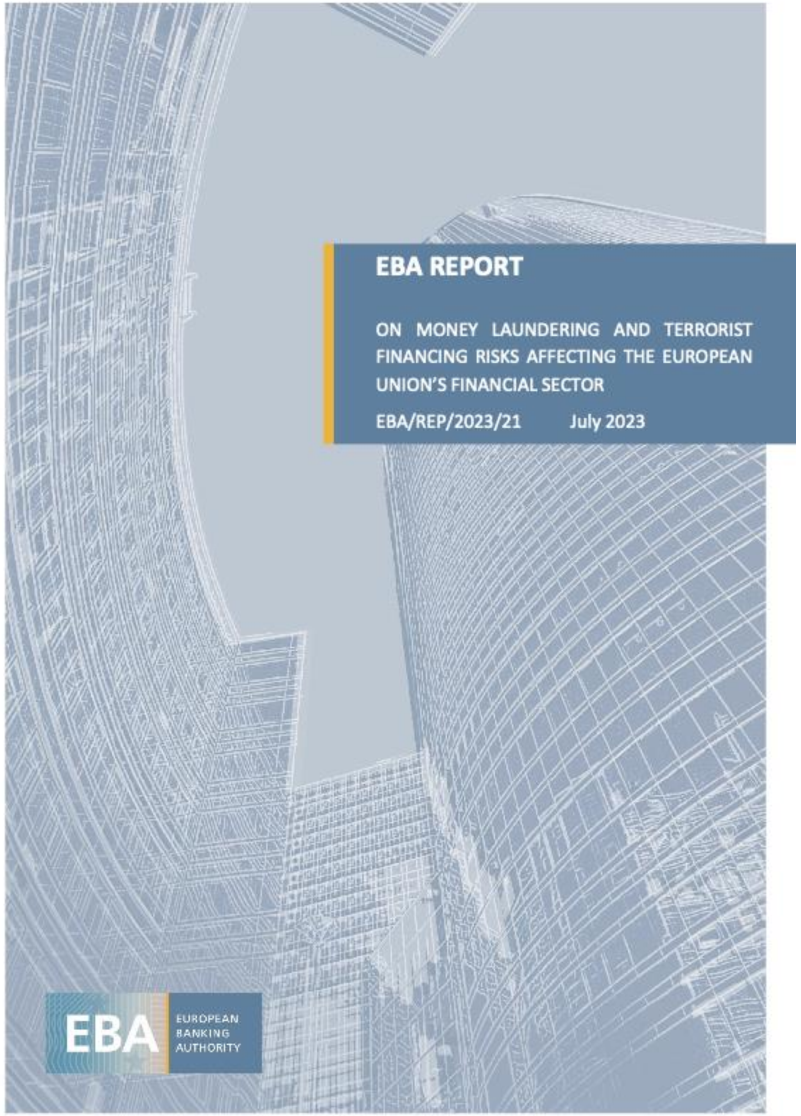
Global and regional reports – main sources

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

Example: EBA reports

- The **EBA competence to deliver an Opinion on ML and TF risks affecting the EU's financial sector** is based inter alia on Art. 6(5) of the EU AML Directive, which requires the EBA to issue such an Opinion every 2 years.
- This Opinion serves to **inform competent authorities' application of the risk-based approach** to AML/CFT supervision and the European Commission's sNRA. It is addressed to the European co-legislators and AML/CFT competent authorities.
- In **July 2023**, the EBA issued its **fourth Opinion on ML/TF risks**, accompanied by a detailed Report. It is based primarily on data from **January 2020 to January 2023**, including AML/CFT competent authorities' responses to the EBA's biennial ML/TF risk assessment questionnaire, submissions to the EBA's EuReCA database and findings from the EBA's ongoing work

2023 EBA Opinion/Report – 4 types of risks


EBA REPORT

ON MONEY LAUNDERING AND TERRORIST FINANCING RISKS AFFECTING THE EUROPEAN UNION'S FINANCIAL SECTOR

EBA/REP/2023/21 July 2023

EBA EUROPEAN BANKING AUTHORITY

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 & private sector expertise

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

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
- 2024 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 entities) 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 (retail banks versus private banks)
  - 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 (e.g. lending)

03 Aggregated STRIX results

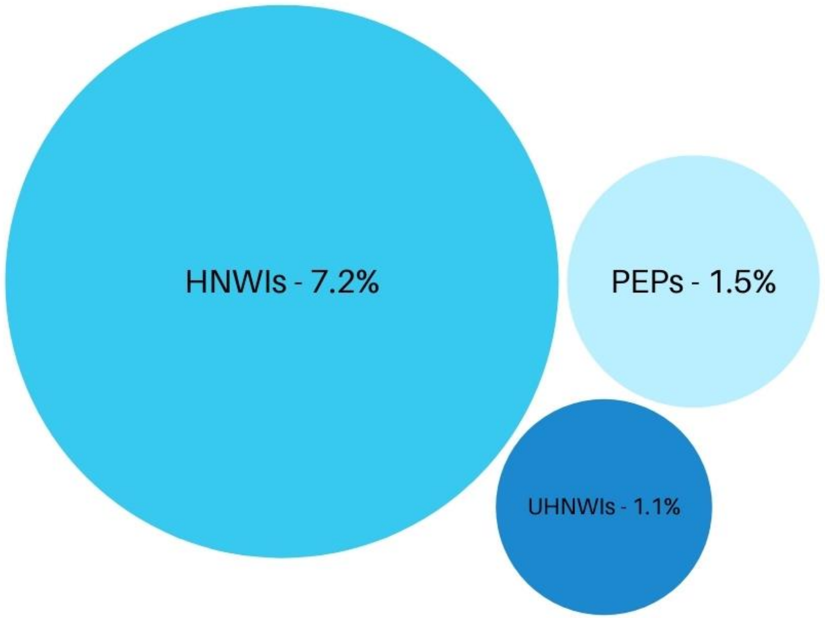
Overall feedback on STRIX returns

- 100% response rate to STRIX survey by banking sector, demonstrating the **strong commitment** of the sector to AML/CFT compliance and good spirit of cooperation with the supervisor
- Data quality overall relatively good and positive developments noted for second STRIX survey compared to first STRIX survey
- Significant room for improvement remains for important subset of banks in relation to the collecting and reporting of data on **customer risk indicators**
- A few outliers remain – a few banks do not report sufficient data on many of the risk indicators, across various risk categories – AMSF will monitor and follow-up where needed

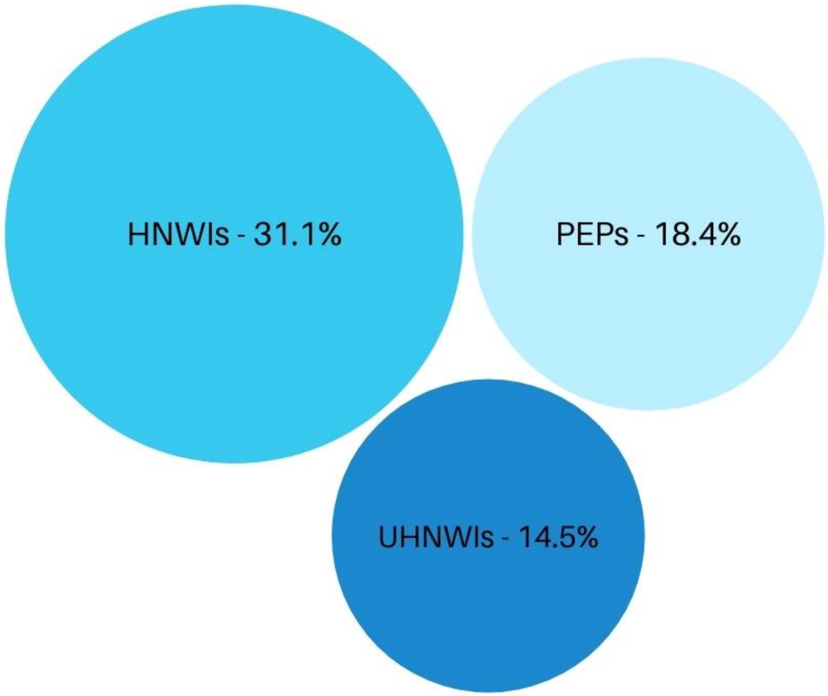
Inherent risks – highlighted findings for customer risks

- **Exposure to PEPs** and **exposure to (U)HNWIs** are very significant contributors to customer risk, both in terms of contribution to the total customer base & to funds transfers, in line with what is expected in context of Monaco as IFC/luxury destination

Contribution to total customer base of banks



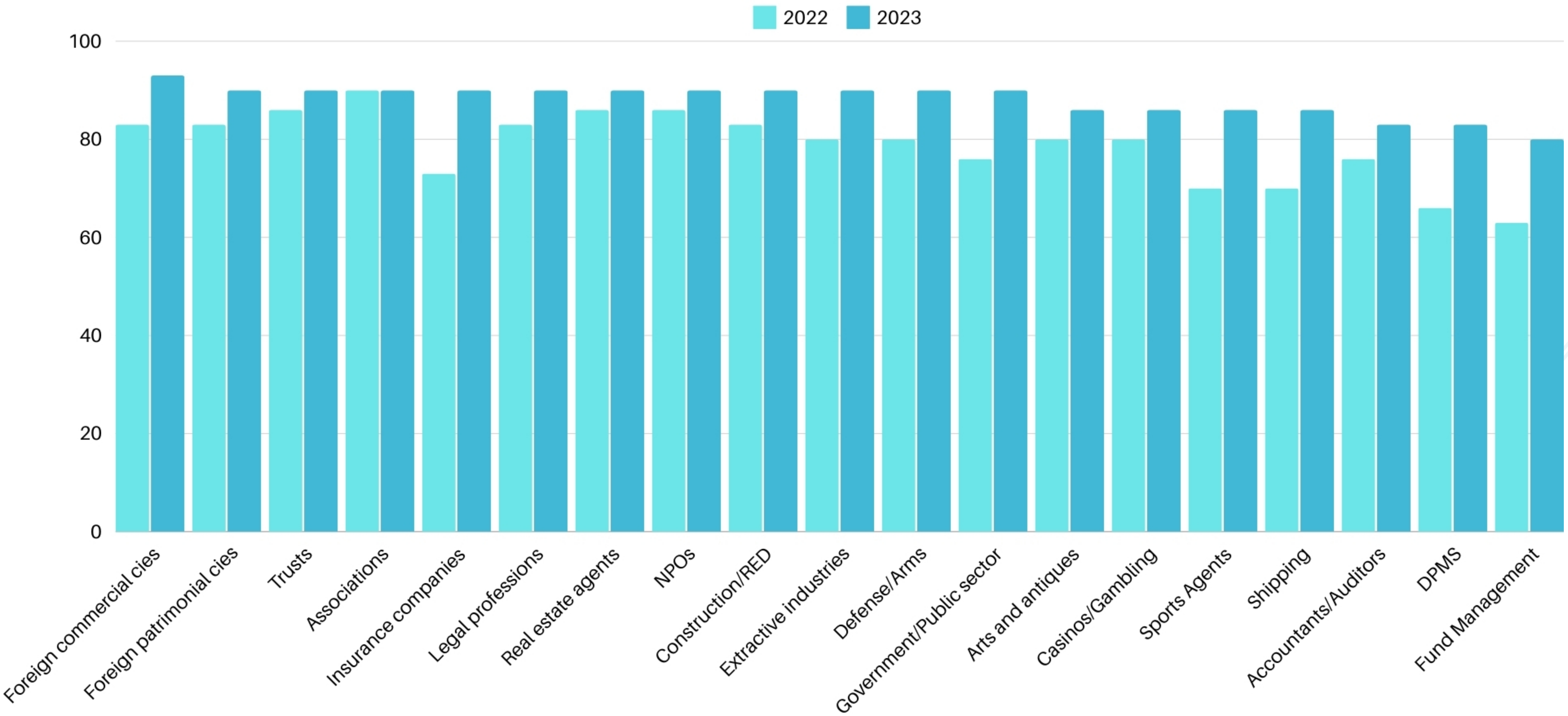
Contribution to total value of funds transfers by banks

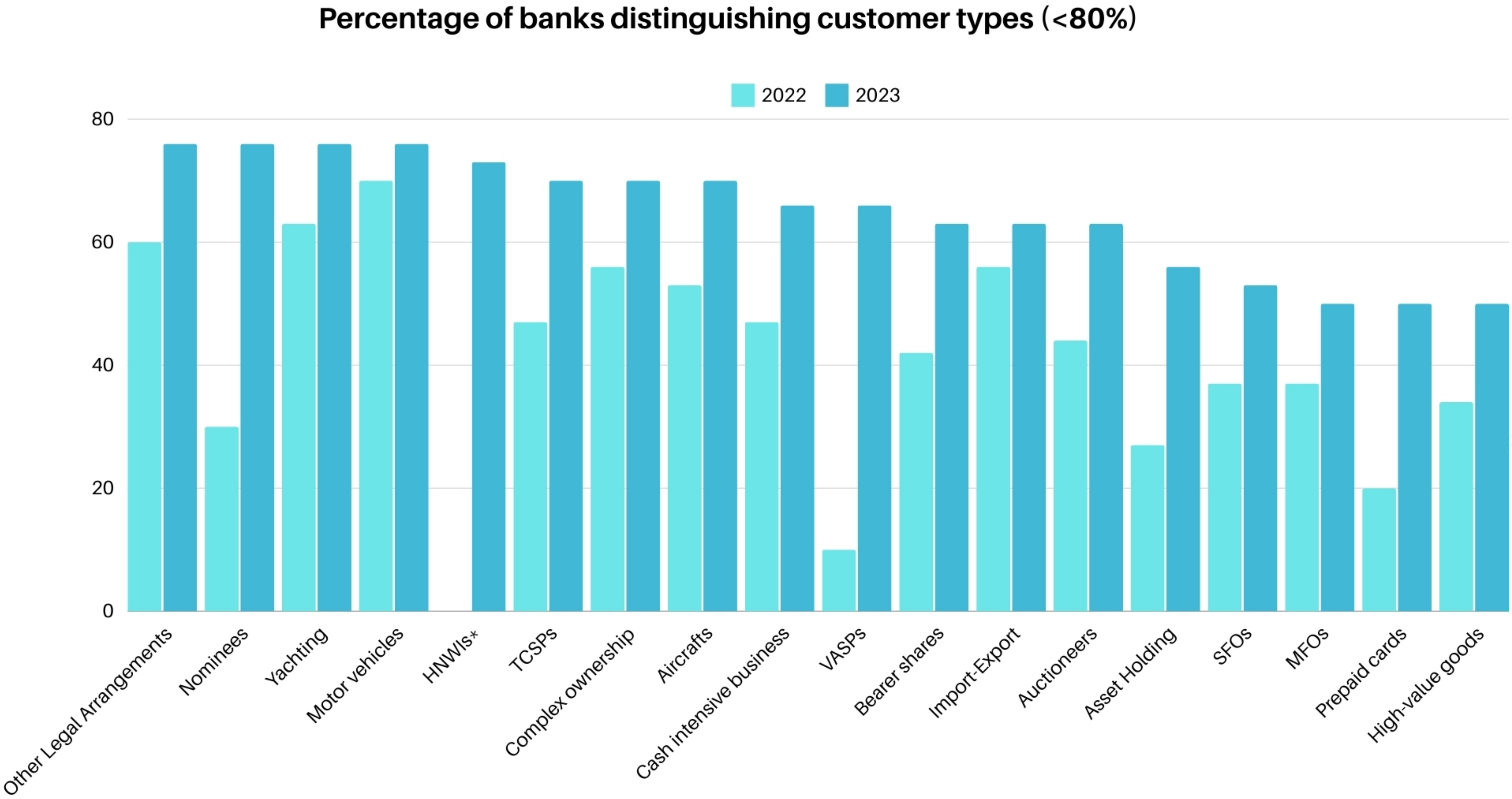


Inherent risks – highlighted findings for customer risks

- STRIX data point at continuing failures by a subset of banks to collect sufficient customer data to inform customer risk profiles, which can lead to tendencies by banks to underestimate customer risk exposure
- Notably:
  - A quarter of the banks still do not distinguish whether customers are **HNWIs**, which is a serious concern in light of **Monaco's country risk profile** and distorts the sector-level data
  - A quarter of the banks still do not distinguish whether customers are engaged in **yachting** business, which is a serious concern in light of the **high sectoral risks** associated to this sector (see NRA 2).
  - More than one third of the banks do not distinguish whether customers are involved in import-export, meaning **Trade-Based Money Laundering risks** (see 2020 FATF/EG reports) through exposure to customers involved in (cross-border) trade may not be sufficiently understood
  - Also gaps in assessment of risks relating to **legal persons** (LPs), e.g. a quarter of banks do not distinguish nominee shareholders and nearly one third do not distinguish whether LPs have complex ownership structures,
- **Important improvements** are noted compared to 2022 (see next slide). Banks should make further efforts to fill the remaining gaps

Percentage of banks distinguishing customer types (>80%)



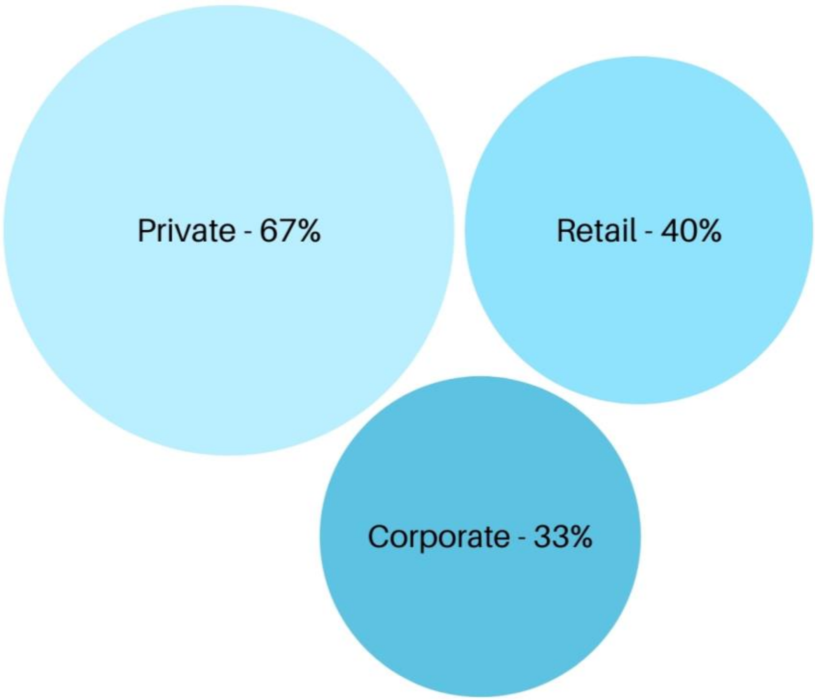


* HNWIs: 2022 no data available

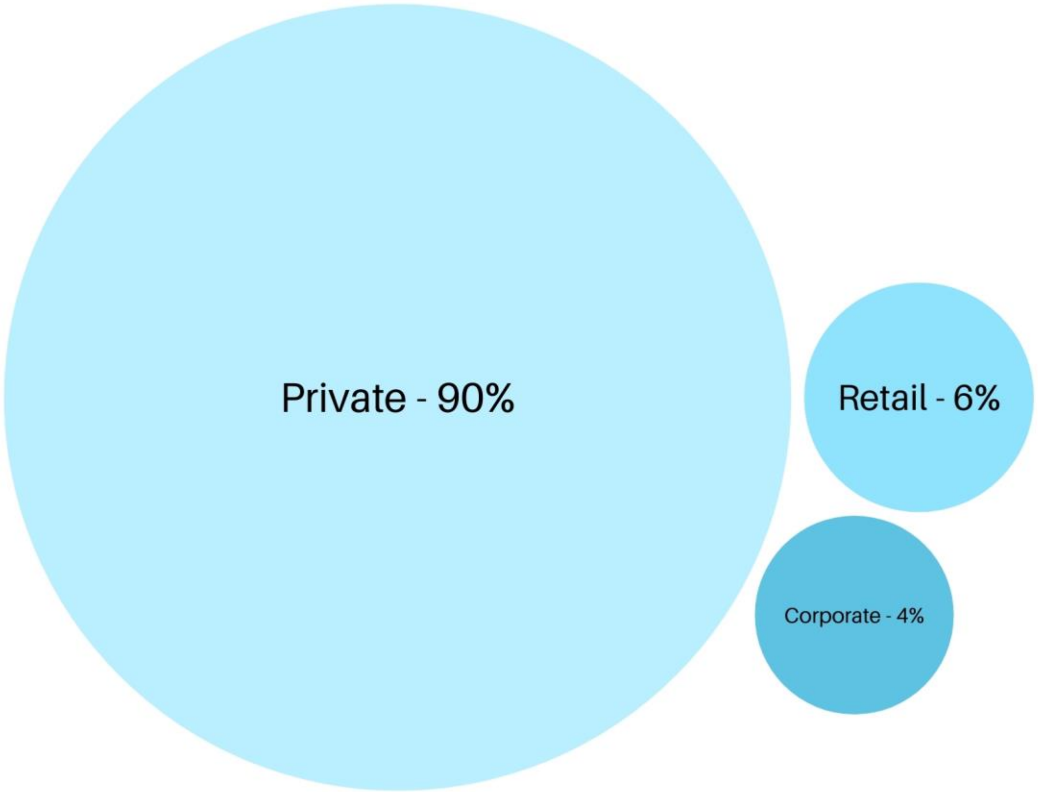
Inherent risks – highlighted findings for services risks

- **Private banking** remains the **most prominent** type of service proposed by the Monegasque banking sector, both in terms of number of banks proposing this service and value of assets under management.
- It shows an **increasing trend** in significance both in absolute terms (value of AUM) and relative terms (% of total AUM)

Percentage of banks proposing private, retail and corporate banking services



Contribution of private, retail and corporate banking services to total AUM of banking sector



ML/TF Risks Associated with Private Banking/Wealth Management

- **Culture of Confidentiality** – the culture of confidentiality in wealth management remains attractive to potential money launderers. Additionally, clients may be reluctant or unwilling to provide adequate documents, details, and explanations.
- **Complex Structures -** The use of services such as offshore trusts and the availability of structures such as shell companies in some jurisdictions helps to maintain an element of secrecy about beneficial ownership of funds and may give rise to significant misuse
- **Complexity of Products and Services** - The inherent complexity of some products and schemes used to serve clients increases ML risks.
- **High-Value Transactions** - The transfer of funds and other assets by customers may involve high-value transactions and rapid transfers of wealth across accounts in different countries and regions of the world; this could facilitate the concealment of illicit funds before the authorities can catch up with them
- **Involvement of Multiple Jurisdictions -** The international nature of private banking increases the likelihood of dealing with illicit proceeds from predicate offenses committed in foreign jurisdictions.
- **PEPs and Risks associated with Corruption** - there are jurisdictions where corruption is known, or perceived, to be a common method of acquiring personal wealth.

→ See AMSF Guideline on Private Banking & Wealth Management on [AMSF website]

Inherent risks – highlighted findings for distribution channel risks

- SRA assesses three main types of distribution channel risks to which the banking sector can be exposed.
- In order of their relative contribution to sectoral risk exposure, this concerns:
    1. Use of client introducers
    2. Third-party reliance for CDD
    3. Use of non-face-to-face onboarding

Inherent risks – highlighted findings for distribution channel risks (cont.)

- Out of these three types of risks, the **first appears most relevant at sectoral level**, **with 70% of banks reporting to accept clients through introducers**, for a total of 7% of the client base. **Geographic risks** are also relevant here: over 90% of customers introduced by third parties are foreign; and foreign introducers (with majority being from outside of EU/EEA) are responsible for introducing +/- one third of the total number of clients introduced by third parties.

- For the second risk, there is a **careful increasing trend in sectoral risk exposure towards third-party reliance for CDD** (relevant for 20% of banks in 2022 versus 27% in 2023). This notwithstanding, there remains only a small subset of banks who rely on domestic or foreign third parties to conduct CDD for a meaningful number of clients; and even for those banks, the proportion of customers remains small (>3%).

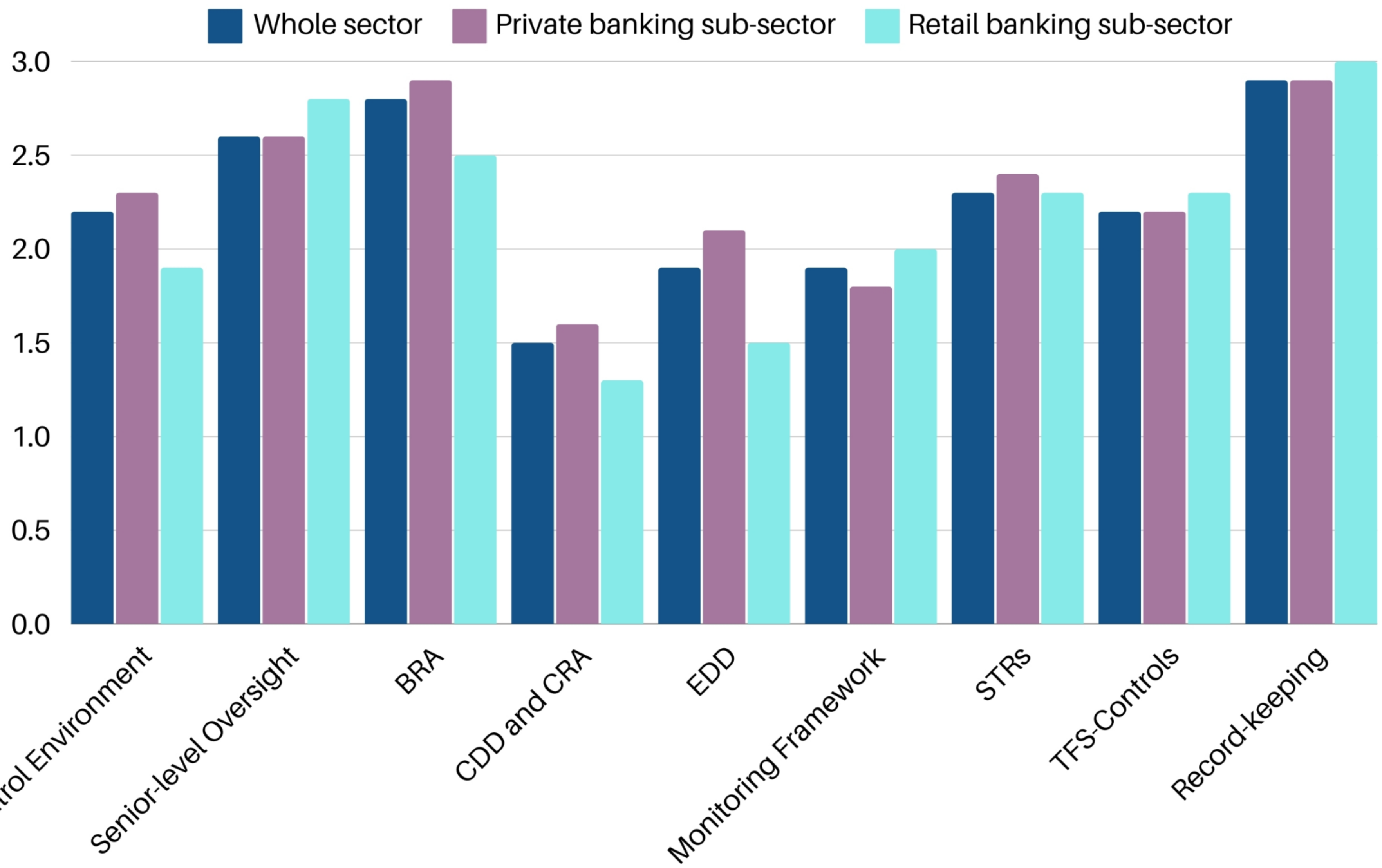
- For the third risk, there is a **careful downward trends in sectoral risk exposure to non-face-to-face onboarding** (relevant for 27% of banks in 2022 versus 20% in 2023) and risks remain limited (<1% of clients). This resonates with findings from NRA 2 which found that remote provision for the majority of services provided by the banking sector was limited in use. It also means that the general increasing trend in remote onboarding and related distribution channel risks, as observed for European banks by the EBA in recent years, especially since COVID, still appears to have limited relevance for Monaco for the time being.

Controls – overall findings on assessed controls

The overall controls score is determined to be "**Moderate**" for the sector

Areas of adequate compliance (av. sectoral score > 2,5 out of 5)	+ Senior-level oversight + Business Risk Assessment + Record-keeping
Areas of moderate compliance (av. sectoral score between 2 – 2,5)	+/- AML/CFT Control Environment +/- Suspicious Transaction Reporting +/- Targeted Financial Sanctions
Areas of weak compliance (av. sectoral score < 2)	- KYC/CDD & Customer Risk Assessment - Enhanced Due Diligence - Monitoring framework

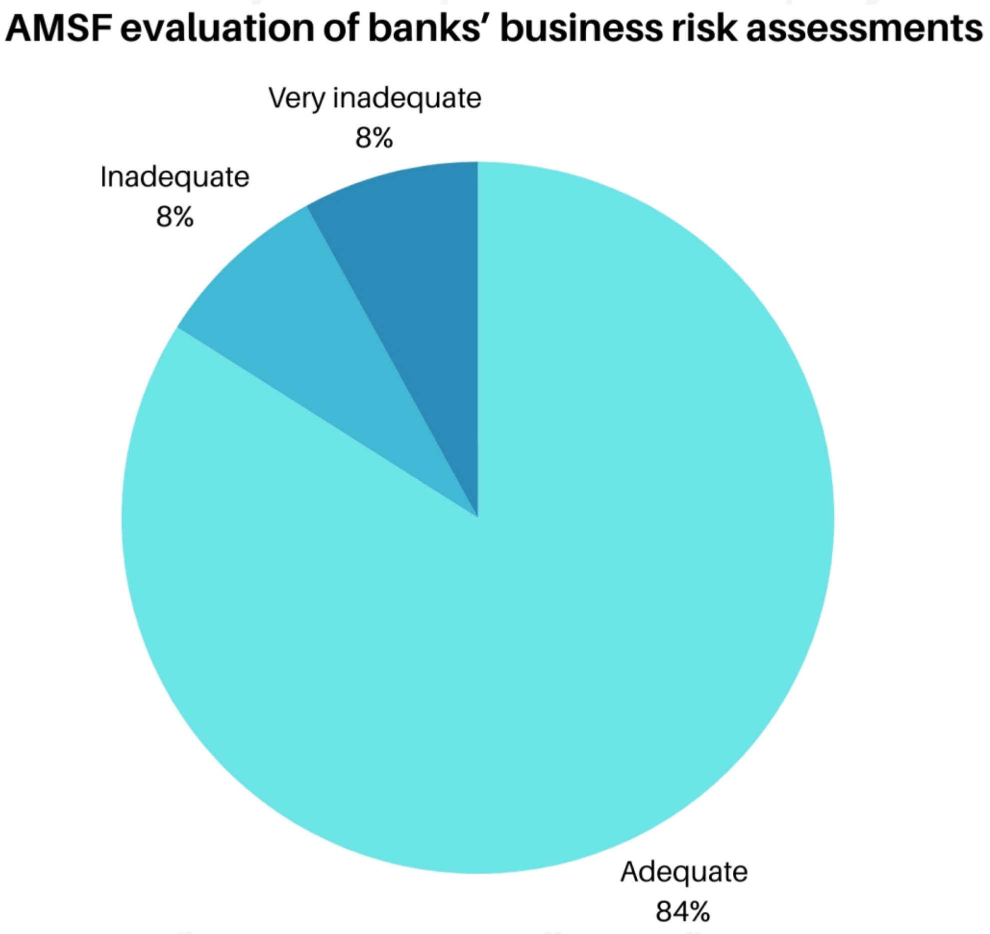
AVERAGE BANKING SECTORIAL AND SUB-SECTORIAL SCORES ON DIFFERENT AREAS OF AML/CFT CONTROLS - reflecting situation as of 30/06/2024



Controls – highlighted findings on BRA

Overall adequate sectorial performance on BRA

- AMSF has observed improvements in recent years in BRA and most of the BRAs are now assessed as “adequate” with only small percentages remaining that are deemed (very) inadequate.
- However, none of the BRAs are assessed as "(very) significant”, since there remains important room for improvement. e.g. by conducting separate analyses of ML and TF risks, making BRAs more comprehensive or more specific to the business of the individual bank, and taking into account new developments or emerging risks.
- See AMSF guidance on BRA

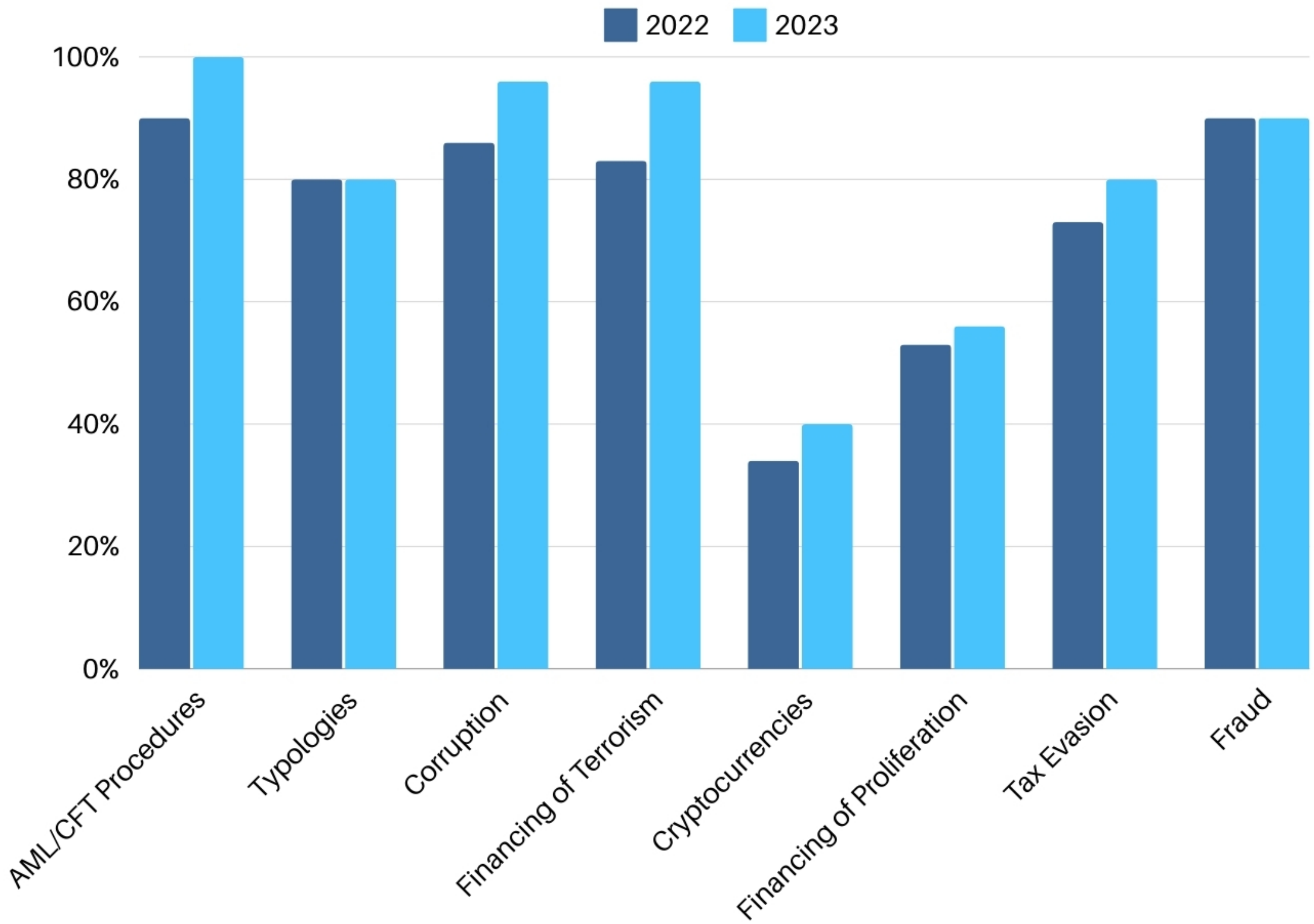


Controls – highlighted findings on internal controls

Overall moderate sectorial performance on control environment

- AMSF has observed improvements in recent years in policies and procedures, including to ensure that they become less generic. However, inspections reveal that group policies are not always in line with Monegasque legislation.
- Positive results in training for client-facing staff, non-client-facing staff, compliance departments and directors/management (nearly 100% trained), with further improvements noted compared to 2022. Internal audit departments still appear to be less well trained for AML/CFT purposes: 63% received training in 2022 and 73% in 2023.
- In general, banks cover a wide area of topics during trainings, and the coverage is improving, but some topics still appear to be underrepresented – see next slide

Percentage of banks covering specific topics in training



Controls – highlighted findings on CRA/CDD & EDD

Overall. still weak sectorial performance on CRA/CDD and EDD

- STRIX data point at failures to collect sufficient customer data to inform customer risk profiles (see slides on customer risk), hence that can lead to:
  - Tendencies to underestimate customers risks; and
  - Absence or gaps in measures to mitigate specific customer risks
- As per inspection results, applied customer risk ratings do not always appear adequate and there can be delays in the review of customer risk profiles
- Thematic inspections on beneficial ownership and complex corporate structures identified cases of failing to identify the beneficial owners by not going far enough down the ownership chain
- Observed improvements in the documentation requested on SoF/SoW
- Findings in Monaco on this point are consistent with sector-specific risks flagged by EBA.

04 Next steps for the SRA

Planning for finalization of 2024 SRAs

- **December 2024:**
  - Roundtables with private sector representatives in order to exchange views on sectorial risks and collect qualitative input from the private sector in addition to the quantitative input provided through STRIX
  - Invitations will be organised through the AMAF
- **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 sectoral 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

Financial Transparency Advisors GmbH
Zieglergasse 38/7/1070 Vienna, Austria

Phone: +43 1 890 8717 11

www.ft-advisors.com

http://www.ft-advisors.com

Next Session:

21.11.2024

Topic:

SRA for asset management sector

Today's Host: Tamar Goderdzishvili

Today's Presenter: Suzanna van Es