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TRANSCENDENT GROUP INSIGHT

Revised EBA Guidelines on money laundering and terrorist financing risk factors

On March 1st the European Banking Authority (EBA) published its final version of the revised Guidelines on money laundering and terrorist financing risk factors (ML/TF), EBA/GL/2021/02 (the Revised Guidelines). These guidelines will repeal and replace the original Risk factor Guidelines published by the European Supervisory Authorities (ESAs) in 2017 (JC 2017 37). In EBA:s own words the Revised Guidelines are "central to the EBA's work to lead, coordinate and monitor" the fight against ML/TF. The Revised Guidelines apply to banks and financial institutions same as the replaced version.

In this article I will look at why the EBA decided to change the guidelines, what is new in the updated version and draw some conclusions as to what this may mean for financial institutions.

Why did it need to be changed?

The original Risk factor Guidelines was published in line with article 17 and 18(4) of Directive (EU) 2015/849 (AMLD4), which requires the ESAs to issue guidelines to support financial firms and competent authorities (CAs) in their AML/CFT work. These guidelines set out risk factors to be considered by firms when assessing ML/TF risk and how customer due diligence (CDD) measures could be used in proportion to the identified risks.

So far so good. But then what happened?

- First, in 2018 – Directive (EU) 2018/843 (AMLD5) entered into force – which warranted a revision of the original guidelines to ensure their relevance and accuracy
- Second, the ESAs Joint Opinions of 2017 and 2019 on ML/TF risk cast light on concerns from CAs across Europe on financial firms adequacy in performing business-wide and individual risk assessments and applying CDD measures proportionate to identified risks, which lead to an update of the original guidelines aimed at achieving a common understanding by firms and CAs in the EU of what the risk-based approach to AML/CFT entails and how to apply it
- Third, following changes to Regulation (EU) No 1093/2010 by Regulation (EU) 2019/2175, since Jan 1st 2020, the EBA is *sole responsible* for leading, coordinating and monitoring AML/CFT efforts across the entire EU financial sector; meaning that the mandates of the ESAs has been consolidated within the EBA.

Needless to say, a lot has happened in the AML/CFT universe over the past years and the EBA seems to be taking its newfound role as the central authority for AML/CFT matters with the outmost importance.

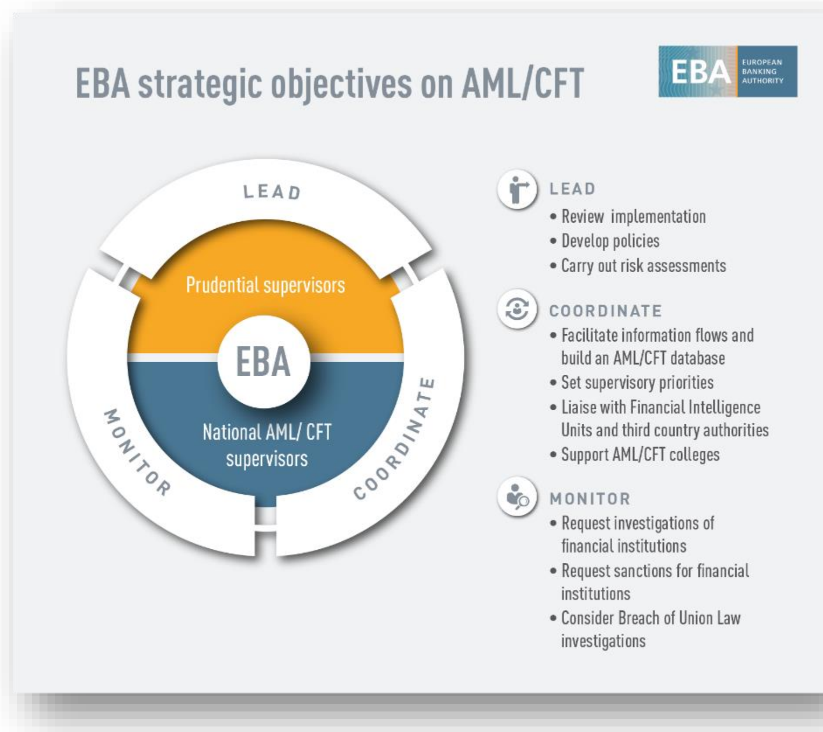

Figure 1. EBAs new role and objectives. Source: EBA AML CFT Fact sheet.

What is new in the Revised Guidelines?

In the EBA's own words the Revised Guidelines "aim at strengthening the EU's AML/CFT defenses by aligning the requirements with recent changes in the legal framework in the EU, and addressing new ML/TF risks." They also purpose to "support effective and consistent supervision by competent authorities of financial institutions' risk-based approaches to AML/CFT".

The layout of the Revised Guidelines is similar to the replaced version in certain aspects. Similar to before there is a *Title I* that applies to all firms and a *Title II* that is sector-specific. However, there have been some interesting additions, clarifications as well as editorial amendments that should serve firms well in their AML/CFT work.

These are the main points of revision:

1. Strengthened requirements on risk assessments

Guidelines 1–3 talk about risk assessments; key principles for all firms as well as identifying and assessing ML/TF risk.

Guideline 1 has been revised to clarify the requirements for the business-wide and the individual risk assessments with a stronger focus on **methodology, documentation and information aspects**. There is a section that covers the linking of the business-wide and the individual assessments (1.18–1.20) and how this should be conducted, which basically states that the business-wide and individual risk assessments should be used to inform one another in a sort of "lessons learned" way.

Further, there is a new section (1.6–1.10) on **keeping risk assessments up to date**. This entails that firms should have systems and controls in place to ensure that business-wide and individual risk assessments are up to date and relevant. Here the EBA mentions that firms should set dates for such updates, handle emerging risks as soon as possible and carefully

record issues over relevant time periods. EBA also mentions how and what types of internal and external information firms should consider as part of these systems and controls. Guidelines 1.29–1.32 states relevant information sources and here the EBA has clarified that firms should normally not rely on only one source to identify ML/TF risk.

Another new addition is a section about **implementation of the business-wide risk assessment** (1.17) which states that firms should

1. make their business-wide risk assessment available to competent authorities,
2. ensure that relevant staff understand the business-wide risk assessment and
3. make sure that senior management understand, and take a view on, the risk to which the firms business is exposed.

Guideline 2 talks about **identification of ML/TF risk**. The main change to this section is that it provides some more detail on how to identify TF risks as well as some editorial edits.

Guideline 3 addresses how to **assess ML/TF risk**. This section includes advice on how firms should gain a holistic viewpoint as well as how to do weighting of risk factors and categorization of risk. Overall the EBA has clarified previous standpoint on the assessment of risk and made some editorial adjustments.

2. Stricter requirements on CDD

Guideline 4 addresses new stricter requirements for CDD measures. This sections has been re-worked for clarity with a few new additions. Initially, EBA states that firms should build CDD measures on relevant information, enabling staff and senior management to understand the CDD policies and take an informed view based on these (4.1–4.4).

Guideline 4.7 is new from before and something of a portal paragraph that clarifies what firms should state in their policies and procedures regarding CDD measures, including setting a **risk appetite**.

The relevant additions regarding CDD measures are:

- the identification of beneficial owners (1.24 a–b, 4.7a, 4.12–4.26):
  - Firms should ask who is the beneficial owner, document it and verify the information
  - Firms should have enough understanding of customers' ownership and control structure to understand and be able to assess the inherent risk
  - Firms should pay attention to persons who exercise "control through other means"
- the use of innovative solutions to identify and verify customers' identities (4.32–4.37):
  - Firms should be aware of the exacerbated ML/TF risks connected to use of new technologies, particularly in non-face to face situations
  - Firms that use external providers of technical solutions will remain responsible for meeting CDD requirements
- Firms compliance with legal provisions on enhanced customer due diligence (EDD) related to high-risk third countries (4.53–4.57):
  - EBA states that firms *should* apply the EDD measures mentioned in art. 18a (1–2) of AMLD4, where applicable
  - EBA establishes criteria for how to determine when a business relationship or transaction involves a high risk third country

3. Financial inclusion and de-risking

The EBA had noted from the Consultation Paper (JC 2019 87) in 2020 that several firms found it challenging to comply with AML/CTF requirements while adhering to financial inclusion. In

response to this EBA has added Guidelines 4.9–4.11 and 4.68 which clarify that firms are not required to refuse or terminate business relationships on the grounds that a customer or categories of customers present higher ML/TF risk ("de-risking"). Firms should carefully balance the need for financial inclusion with mitigation of ML/TF risk, and in this create appropriate and risk sensitive policies ensuring that their application of CDD measures does not result in denying legitimate customers access to financial service for unduly reasons.

4. Record-keeping, training and effectiveness

Guidelines 5–7 are new and specify advice around firms' record-keeping, training of employees and regular assessment of the effectiveness of their approach to AML/CFT. In short:

- Firms must keep records of CDD information, risk assessments and transactions. Records should be sufficient to demonstrate that actions taken are adequate
- Training must be tailored to staff according to their duties and ensure that they understand the business-wide risk assessment, policies and procedures and know how to recognize suspicious behavior and transactions and how to handle such cases
- Firms should regularly assess the effectiveness of their AML/CFT work and determine the frequency and intensity of such assessments based on risk sensitivity and size and nature of the business.

5. New sectoral guidelines

The sectoral guidelines in Title II has added guidance for the following sectors:

- crowdfunding platforms,
- corporate finance,
- account information service providers (AISPs) and payment initiation services providers (PISPs) and
- firms providing activities of currency exchanges offices.

Reflections on the changes

1. Strengthened requirements on risk assessments

As I have talked about in a previous article about the Draft Guidelines, strengthened requirements on risk assessments have been expected and requested due to the fact to CAs and financial firms view on the risk-based approach have differed and led to misunderstandings. The EBA thus have clarified its requirements and I welcome these updates.

I have myself seen misunderstandings on the risk-based approach first hand and believe that this is one of the big challenges that come with centralized regulations and supervision such as the AML framework and the EBA. Differences in cultural approaches to legal work in the EU countries as well as different legal histories are what make such cross-border implementations difficult, simply because a risk-based approach mean different things to different people in different countries. I will refrain from commenting on the centralized approach and EBAs' new role, as that in itself is subject matter of another article. During the current circumstances, I think that an update to the original Guidelines was mandated, especially the focus on proper documentation and information and keeping these updated, working in a "lessons learned" capacity and a clearer stance on how to implement an internal AML framework.

2. Stricter requirements on CDD

In this section I would like to highlight the fact the EBA now has stated that firms should formulate a **risk appetite** in their policies and procedures. This is a new addition from before and something that I believe will lead to many discussions among compliance officers as we go forward. *I mean, will a firm be comfortable saying that it accepts a certain amount of ML/TF and if so how much?*

There are many aspects to formulating a risk appetite for an internal AML framework. One is how the organization should measure its appetite (quantitative). Another is whether to have a principal risk appetite on a high level (qualitative) that can be broken down into different segments (customers, products etc.). The options are many and I believe that is why the EBA hasn't gone into more detail as to how firms should formulate their risk appetites.

Further, I'd like to highlight the guidance around **innovative solutions to identify and verify customers' identities.** This is something I've had a keen interest in myself the past few years and have been following the developments. I think it is imperative that firms follow the guidance in this part and make sure to properly assess any technological means before implementing them into their internal AML framework. Firms should also be prepared to demonstrate to CAs that their tech solution of choice is appropriate.

Needless to say, the development on these matters will be most interesting to follow.

3. Financial inclusion and de-risking

This may be my favorite part of the Revised Guidelines as I have first hand seen how banks de-risking have led to legitimate businesses being threatened of going out of business, for the simple fact of being a business that suggest a higher ML/TF risk. One case is a known retailer of luxury goods that got their bank accounts canceled with no prior explanation and no willingness to discuss the matter. This in effect meant a ban for the retailer to conduct business, even though this retailer didn't handle cash and thus is not encompassed by the AML framework.

We live in a society where businesses are required to have a bank account to comply with legal requirements. An order where banks de-risk due to the fact that a certain product or service is attractive to criminals is not sustainable in the long run. It is therefore a most welcome addition that the EBA now has clarified that financial firms need not de-risk certain customers or categories of customers with higher ML/TF risk. I hope many compliance departments reflects on this as we go forward.

4. Record-keeping, training and effectiveness

Guidelines 5–7 are an expected addition as these matters haven't been addressed in full in the original guidelines. They are short and to the point and should provide some more insight to firms on how to implement this in their policies.

I would like to highlight Guideline 7.2 which states that firms should consider an **independent review** of their AML/CFT approach. In my experience this is solid advice that firms should consider. Many organizations, even those that have a good AML framework in place, tend to be set in habits, which makes it harder to see potential improvements. By improvements I mean ways to perform the AML/CFT task with greater efficiency and at a lower cost. An independent review of the internal framework can help achieving better results.

5. New sectoral guidelines

The sectoral guidelines are a welcome addition, where the Revised Guidelines take into account especially new payment service providers and crowdfunding, which have

developed over the past few years and become more prominent in the face of ML/TF risk. These emerging businesses have in some ways yet to experience ML/TF risk similar to other financial institutions and thus guidance as to how to comply with the AML framework is welcomed.

Regarding the contents of the sectoral guidelines, I will refrain from commenting on these here, as each could be the subject of their own article.

Concluding reflections

In summary, the most interesting news in the Revised Guidelines are:

- Firms should focus on improving their documentation of the AML/CFT work, set controls for keeping the documentation up to date, and include lessons learned from both the business-wide and individual risk assessments
- Implementation of the business-wide risk assessment needs to be preceded by informing senior management in a way that they can understand the risk assessment and make decisions based on it
- Firms should formulate a risk appetite in their internal AML framework
- Firms should properly assess any technological solutions they use for CDD
- Firms need not de-risk a customer that suggests higher ML/TF risk
- Firms should consider an independent review of their AML/CFT approach

Let us know your thoughts and questions! How will this affect your firm's AML/CTF work?

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