Risk Based Approach

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Definition

A risk-based approach means that countries, competent authorities, and institutions ***identify, assess, and understand*** the money laundering and terrorist financing risk to which they are exposed, and take the appropriate mitigation measures *in accordance with the level of risk*.

Application & Scope

- Adopting a risk-based approach implies the adoption of a risk management process for dealing with ML/TF, the scope should cover all branches and subsidiaries.
- A risk analysis must be performed to determine where the ML/TF are the greatest. Main vulnerabilities should be identified and addressed accordingly.
- Determine the strategies to manage and mitigate the identified ML/TF risks.
- Proportionate procedures should be designed based on assessed risk.

These are not static assessments. They will change over time.

Responsibility of ?
EVERYONE !

On country level	• National Risk Assessment
Competent Authorities	• Sectorial risk assessment • Institutional risk assessment
Institutions	• Self-risk assessment

Top management is responsible for the overall risk management environment. **Compliance** employees are responsible for the ML/TF risk assessment and detecting areas of weaknesses . Yet , first line employees and others within the institution play an important role in combating ML/TF.

*Image source: https://globalfinance.mu/practical-risk-based-approach-to-aml-cft/

Benefits

Better management and treatment of risks

Cost-benefits due to the efficient proportionate allocation of resources to risks

Financial institution focus on real and identified threats.

Flexibility to adapt to risks that change over time.

Enhanced compliance with regulations , laws , and FATF Recommendations !

Challenges

Identifying appropriate information to conduct a sound risk analysis.

Addressing short term transitional costs.

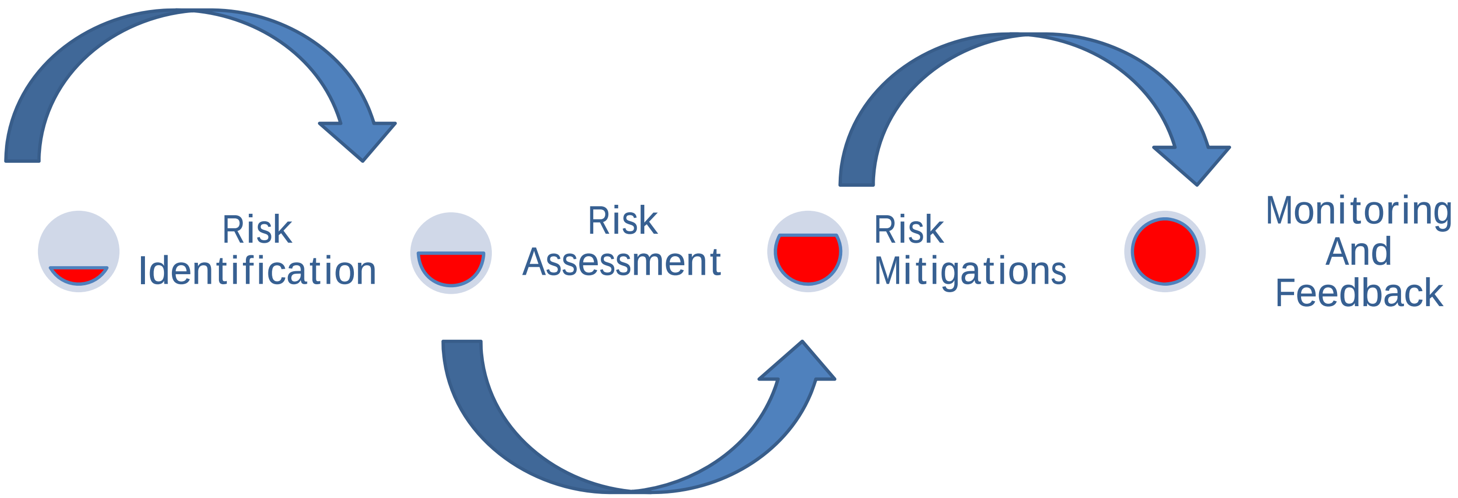
Greater need for more expert staff capable of making sound judgments;

Regulatory response to potential diversity of practice.

FATF Recommendations !

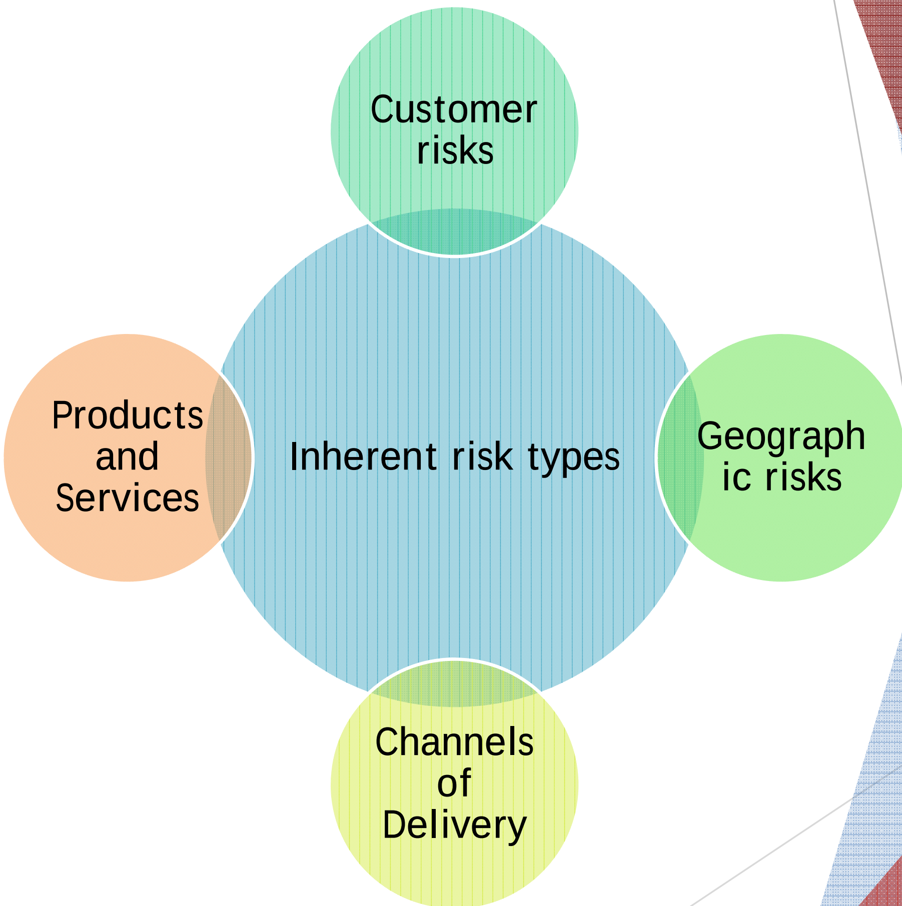
- The adoption of the risk-based approach (RBA) by financial institutions in the field of combating money laundering and terrorist financing is a mandatory requirement in accordance with the recommendations of the FATF :
  - Specifically Recommendation:
    - No. (1) the risk-based approach
    - No. (10) Customer due diligence (The extent of CDD measures should be determined using a risk-based approach)
    - No. (26) Regulation and supervision

Stages of RBA

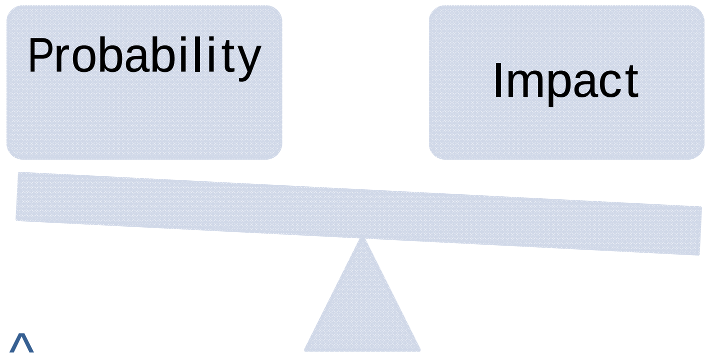


Risk Identification

- Identify type and nature of ML/TF risks in business operations of FIs. (Inherent Risk)



Risk Assessment



- Measure and Quantify …. Think ^
- Slice Risks into levels

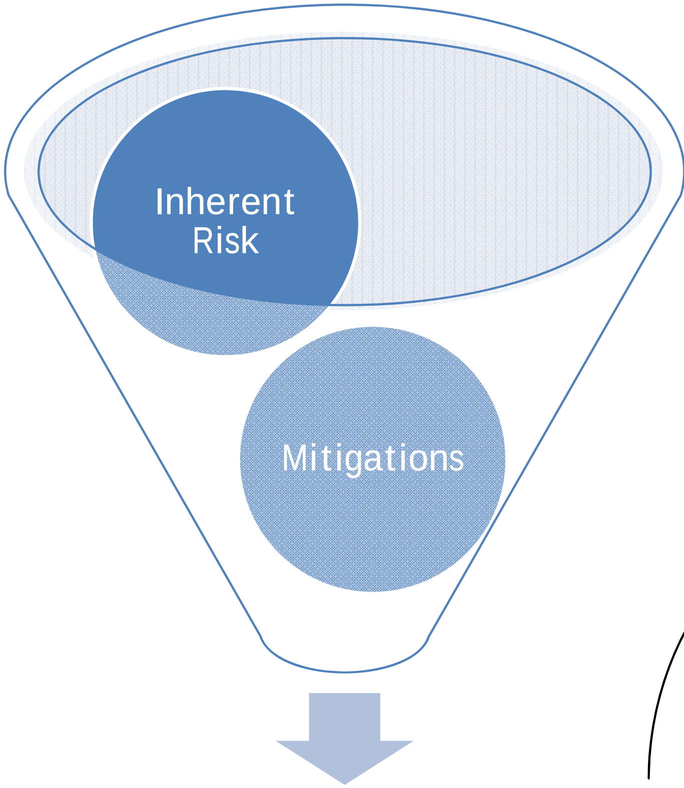
  Low , Medium , High

Risk Mitigations

Nature? Detective , preventive , corrective

Applied through :

- Corporate governance
- Risk management
- Polices and procedures
- Internal controls and measures
- Resources



Residual Risk

Residual Risk Treatment ?

- Further Mitigate
- Accept
- Transfer
- Avoid

Monitoring and Feedback

- Given the results of the risk assessment , resources and efforts must be proportionally allocated to risk areas.
- Response plans must be in place for high risk areas
- **Monitoring of all risk areas within all levels (low, medium , high) must be present** , then what distinguishes a risk based from a rule based approach ? *The level , extent and timing of the monitoring.*
- Feedback : What worked well and what didn't ! Maintain or enhance what went well , and fix what didn't go well !
- Again , Risk assessment is not static !!! Update as needed When needed

Think Smart here lies a lot of the potential of being successful

Effective RBA

- Clearly defined policies and procedures including the methodology of risk self assessment
- Strong governance and "tone from the top" to emphasis importance of AML/CFT.
- Clear risk identification and quantification process
- Timely and constant monitoring of risk areas
- Emphasis on an effective transaction monitory system
- Proactive approach to risk treatment

But should everything be Risk based ??

- Requirements to freeze assets of identified individuals or entities, in jurisdictions where such requirements exist, are independent of any risk assessment. The requirement to freeze is absolute and cannot be impacted by a risk-based process.
- Similarly, while the identification of potential suspicious transactions can be advanced by a risk-based approach, but the reporting of suspicious transactions, once identified, is not risk-based.

Role of supervisory authority – specifically CBJ

- Supervisors should understand country, sectoral and institutional risks.
- Supervisors should obtain information on such risks, quality of risk management and compliance.
- Scope and frequency of supervision, including onsite inspections, should be risk based.
- Institutional risk profiles should be reviewed, & updated as needed.
- CBJ conducts the institutional and sectorial risk assessment related to sectors under its supervision , onsite and offsite inspections ALL in line with FATF Recommendations.