



Advisory

Financial Transactions Reporting Act

Reference: 5/2007

Date: 22nd June 2007

Re: Risk Based Approach

A. Purpose of this Advisory

1. Financial Institutions are required to implement their obligations under the Financial Transactions Reporting (FTR) Act and Regulations on a “risk-based” approach. This means that the type and extent of measures undertaken for each of the requirements under the FTR Act and Regulations should depend on the materiality of *risk of money laundering and terrorist financing associated with customers and transactions*.
2. This approach is to ensure that a financial institution will focus its efforts and resources on those customers and transactions that potentially pose the greatest risk of money laundering and terrorist financing.
3. This Advisory aims to provide guidelines on factors that a financial institution should consider when developing and implementing a risk based approach implementation of the FTR Act and Regulations. Each financial institution should determine its own risk based processes depending on the nature and size of its operations and the types of products and services offered by the financial institutions to its customers.

B. How to Apply the Risk Based Approach?

4. The risk based approach of adopting the FTR Act and Regulations involves the following steps:
 - i. **Identifying and Assessing Risk** - a financial institution should first identify the risk of money laundering and terrorist financing that it faces given its *customers, products and services, delivery channels and geographical profile*. Once it has identified these risks, the financial institution should assess the potential scale of these risks.
 - ii. **Treating the Risks** – once a financial institution has identified and assessed the risk of money laundering and terrorist financing that it is vulnerable to from its customers, it must determine and apply appropriate measures and controls as required under the FTR Act and Regulations to treat or mitigate the material risks identified in Step (i).
 - iii. More stringent measures and controls for customer identification and verification; and more regular and strict monitoring procedures will need to be applied to high risk customers as compared to medium or low risk customers.
 - iv. **Monitoring Risks** – the financial institution must put in place systems to regularly monitor its risk profile (as determined in Step i and ii) and to keep this risk profile up to date in accordance with changes to the business environment and money laundering and terrorist financing trends.
 - v. **Documentation** – the financial institution must document its risk assessment process. This must also include the AML and CFT measures and controls identified in Step (ii).

C. *How to Identify and Assess Money Laundering and Terrorist Financing Risk*

5. A key component of the risk based approach is for financial institutions to *identify* and *assess* the *magnitude of risk of money laundering and terrorist financing* associated with its customers and transactions.
6. Determining risk requires professional as well as, to some extent, personal judgment on the part of the financial institution and reference to reported trends or typologies on money laundering and terrorist financing. When identifying and assessing the risk of money laundering and terrorist financing, a financial institution should consider the following factors:
 - i. **Country:** There is no universally accepted rule on which countries should be regarded as high risk countries for money laundering and terrorist financing. However certain factors that may cause a country to potentially pose a higher risk on a financial institution are:
 - If the country is identified by the Financial Action Task Force (FATF) as a non-cooperative country in combating money laundering;
 - If the country lacks appropriate money laundering laws and regulations or has weak measures for combating money laundering and terrorist financing as identified by credible sources such as the World Bank;
 - If it is identified by credible sources as having high levels of corruption or other criminal activity;
 - It has been identified by credible sources such as the United Nations as providing funding or support for terrorist activities.
 - ii. **Customer Type:** Based on money laundering and terrorist financing typologies, methods and trends, customers with the following characteristics will potentially pose a higher risk of money laundering and terrorist financing on financial institutions:
 - Unregulated non profit organizations or charity organizations;
 - Cash intensive types of businesses, (eg foreign exchange dealers; remittance service providers);
 - Politically exposed persons or persons who are or have been entrusted with prominent public functions in a foreign country. This also includes their family members and close associates.
 - Businesses dealing in high value or precious goods (eg jewelry and other precious stones, real estate dealers, art and antique dealer)
 - Use of an intermediary within the relationship (eg trust accounts or accounts for persons maintained and operated by professionals such as accountants and lawyers);
 - Entities or professionals with minimum or no regulatory supervision. (eg corporate entities other than publicly listed companies). Criminals may set up corporate entities and other similar arrangements as a cover to carry out financial transactions. Likewise certain professions with inadequate regulatory supervision are prone to abuse by criminals for laundering of proceeds of crime. Eg unregulated real estate agents.
 - iii. **Product or Services:** certain products or services offered by the financial institution may pose higher risk of money laundering and terrorist financing due to the nature of the product or service. Some such services or products which are considered as having a higher risk of money laundering and terrorist financing are:
 - International correspondent banking services;
 - International wire or electronic fund transfers

- iv. **Geographical Profile:** the geographical profile of a financial institution will also impact on the level of money laundering and terrorist financing risk it is exposed to. A financial institution located in a highly commercialized and populated area and serving a bigger and more diverse customer base will face higher level of risk compared to a financial institution in a smaller and less commercialized locality.
7. A financial institution may consider the above four factors to identify and assess the risk of a customer or transaction.
8. When considering the above four factors, a financial institution may design and assign a weight or a ranking system to the factors individually or collectively to clearly differentiate customers of high risk.

D. *Monitoring Customers' Accounts for Changes in their Risk Status*

9. Customers (or products) which may have been assessed as having low risk during the account opening stage may develop into high risk customers during the course of the relationship. For example a low risk customer may start receiving and sending a significant number of international electronic fund transfers for no rationale reason.
10. Likewise customers that were considered as high risk customers during the account opening stage may have minimal and low value transactions going through their account over time thus warranting the financial institution to treat the customer as a low risk customer within its overall operations.
11. Thus the continuous monitoring of transactions and customers' accounts is important to identify any change in the risk status of a customer. A change in the risk status of a customer or an account will warrant the appropriate adjustment in the level and type of monitoring of the account.
12. Thus a low-risk customer who has been subjected to moderate level of monitoring checks should be subjected to more stringent monitoring once the customer develops into a high risk status and vice versa.

E. *Adoption and Implementation of Procedures, Policies and Controls*

13. A financial institution must document its risk assessment process as part of its internal policy. The types of measures and controls for anti-money laundering and terrorist financing that a financial institution decides to apply; as a result of its risk assessment must also be documented as part of its internal policy and procedures.
14. These policies, procedures and controls should be approved by management and subjected to compliance testing by a financial institution's internal audit function as well as by the relevant supervisory authority and the FIU.
15. Financial institutions should consult the FIU for further clarifications.



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