Preventing money laundering and terrorist financing: summary of risk assessment for the credit institution sector

Content

1 Purpose and scope of application of the sector-specific risk assessment

The sector-specific risk assessment of money laundering and terrorist financing for credit institutions is the Financial Supervisory Authority's (FIN-FSA) assessment of the money laundering and terrorist financing risks for credit institutions at the sector level. In the FIN-FSA's inherent risk assessment of money laundering and terrorism financing risks related to different sectors were examined at the top level and only from the standpoint of the products and services typically provided in the sectors. For the sector-specific risk assessment, the FIN-FSA studied in more depth the products and services offered by credit institutions operating in Finland, customers, distribution channels and geographical coverage. In addition, risk management methods have also been taken into account. The assessment is formed at the sector level, however, not at the level of individual supervised entities.

The risk assessment guides the FIN-FSA both in directing supervisory resources and selecting supervisory measures based on risk. In accordance with the guidelines on risk-based supervision issued by the European Banking Authority (EBA), the FIN-FSA must prepare a supervision strategy for preventing money laundering and terrorist financing, a key element of which are risk assessments for the various supervised sectors. The supervision strategy takes a position on how to react to the identified risks and on the kind of supervisory measures directed at different supervised entities. The supervision strategy, moreover, serves as the basis for more detailed supervision plans.

The risks identified in the risk assessment of the credit institution sector and the weaknesses identified in the risk management methods guide the supervisory measures directed at the credit institution sector by the FIN-FSA. The sector-specific risk assessment gives, above all, a top-level assessment of the risks related to the management methods. Verifying the effectiveness of management methods and compliance with the obligations of the Act on Preventing Money Laundering and Terrorist Financing (444/2017) therefore always requires more detailed supervisory measures.

The credit institutions referred to in chapter 1, section 7, subsection 1 of the Credit Institutions Act (610/2014) fall within the scope of the sector-specific risk assessment. In accordance with the EBA's guidelines on risk-based supervision of the prevention of money laundering and terrorist financing, in its assessment the FIN-FSA has divided credit institutions into subsectors according to the quality, size and scope of their activities.

Traditionally, credit institutions are divided according to their activities into deposit banks and financing institutions. The risk assessment is based on this division, but credit institutions belonging to the same consolidation group have been placed in the same category, regardless of whether they are deposit banks or financing institutions. In addition, in the categorisation, attention has been paid to what services the credit institutions actually provide.

The subsector division used in the risk assessment is as follows:

Group 1

- Domestic deposit banks and branches of foreign deposit banks, as well as financing institutions belonging to the same consolidation group with them, whose size and scope of activities are large. The service range and geographical coverage of these credit institutions is extensive.

Group 2

- Domestic deposit banks and financing institutions belonging to the same consolidation group with them whose size and scope of activities are smaller than the group 1 deposit banks and the geographical coverage of whose activities is narrower.

Group 3

- Domestic deposit banks and financing institutions belonging to the same consolidation group with them, the size of whose activities in the whole of Finland is comparable to the group 2 deposit banks but the geographical coverage of whose activities is more extensive than group 2 deposit banks, among other things due to the fact that the subsector also includes branches of foreign credit institutions.

Group 4

- Domestic financing institutions and branches of foreign deposit banks and financing institutions which do not, in principle, offer deposit services in Finland. These credit institutions are focused on providing various financial services to private and/or corporate customers.

Group 5

- Branches of foreign deposit banks whose activities in Finland are, in practice, representative, so that these branches themselves do not provide services or manage customer relationships; services and customer relationships mainly are entered into with the parent company.

2 Preparation of the risk assessment

When assessing the risks of money laundering and terrorist financing, the FIN-FSA uses the scale presented below, which corresponds to the scale used by the EBA. A risk score is defined to describe each risk level.

Risk level	Risk score corresponding to the risk level
Very significant	4
Significant	3
Moderately significant	2
Less significant	1

The end result of the sector-specific risk assessment is the overall risk levels determined for the entire credit institution sector and its subsectors. Overall risk is determined on the basis of the risk levels determined for the different risk and management method categories. Section 3.1 *Results of sector-specific risk assessment* reviews in more detail the principles followed in determining the overall risk.

The assessment of the risk levels of the risk and management method categories was conducted as follows:

1) Risk category – products and services

In the assessment of risks related to products and services, the inherent risk levels determined for different products and services in the FIN-FSA's assessment of inherent risk are utilised.

The sector-specific risk assessment scrutinised which products and services the credit institutions actually provide and what kind of risk is actually associated with the products and services.

In the assessment of risk, the following aspects, among others, were taken into account:

- What is the content of the services provided?
- What proportion of the credit institutions belonging to the subsector provide the service in question?
- What special characteristics (risk-reducing/increasing features) are associated with the services provided in the subsector in question?

Sources:

- The FIN-FSA's inherent risk assessment of money laundering and terrorist financing and its sources.
- FIN-FSA and the Bank of Finland data collections:
    - RA – reporting of risks and controls concerning money laundering and terrorist financing.
    - MATI – reporting of payment transaction statistics
    - RATI – reporting of statistical data on financial institutions

- Information obtained at the authorisation and registration phase, in ongoing supervision and from supervisors.
- Information obtained in official cooperation, for example from the Financial Intelligence Unit (FIU).

2) Risk categories – geographical risk, customers and distribution channels

In addition to products and services, the risk assessment must also always consider risk factors related to customers, geographical location and distribution channels. In order to assess these risk factors, the information reported on customers, distribution channels and the geographical coverage of activities by credit institutions in RA reporting was reviewed. In addition, with regard to the geographical scope of payment traffic, information collected in the Bank of Finland's MATI reporting as well as information on branches from the FIN-FSA's register of supervised entities and notifications has been utilised.

3) Management method categories

In addition to risks, risk management methods related to money laundering and terrorist financing have been assessed in the risk assessment of the credit institution sector. In the assessment of the risk level of the management method categories, in practice it is the risk related to the weakness of management methods that has been assessed. Management methods are assessed in two stages. First, an assessment is made of whether the legally required management methods are used in the sector. For this, information on management methods reported in RA reporting is mainly used. In the second stage, the adequacy and effectiveness of the management methods are assessed. This assessment draws upon data collected in the authorisation and registration process, ongoing supervision, inspections and through cooperation with the authorities.

3 Risk assessment and its justifications

3.1 Results of sector-specific risk assessment

The FIN-FSA has assessed that the overall risk related to money laundering and terrorist financing in the credit institution sector is **significant**.

In the sector-specific risk assessment, the risks of money laundering and the risks of terrorist financing have been assessed independently insofar as the risks in question relate to products and services. The result of the assessment regarding products and services was that the risk level is the same for both money laundering and terrorist financing. The summary therefore presents one risk level for products and services, corresponding to the risk associated with products and services for both money laundering and terrorist financing.

With regard to geographical risk and risks associated with customers and distribution channels, money laundering and terrorist financing have not yet been separated at the level of sector-specific risk assessment. The reason for this is that, at the sector level, it has not been deemed appropriate to review, for example, the payment traffic of all credit institutions country by country in order to determine whether the payment traffic is directed to areas associated with an increased risk of terrorist financing. A more detailed analysis will be made as part of supervised-entity-specific risk assessments, which will be taken into account later when updating the sector-specific risk assessments. With regard to management methods, moreover, the management methods for money laundering and terrorist financing have been assessed as a single entity.

For each risk and management method category, the risk assessment has determined a risk level and a corresponding risk score. The common risk level of the risk categories is formed from the weighted average of the risk scores of the different categories. With regard to the risk categories, the risk level of products and services has been assigned a relatively greater weight than the other risk categories. The justification for this is that products and services determine how a sector, subsector or individual entity can be exploited for money laundering or terrorist financing. Without products or services that involve a risk of money laundering or terrorist financing, it is difficult for the sector to be exploited for money laundering or terrorist financing. The risk level of the management method categories is the rounded average of the different categories' risk scores.

In the formation of the overall risk level, a joint assessment is made of the risk levels of the risk categories and the management method categories. The risk level of the risk categories has been weighted more in relation to the management method categories. The reason for this is that it is not possible and it is not always appropriate to try to completely eliminate the risk of money laundering or terrorist financing through management methods.

The risk scores corresponding to the risk levels determined for the risk and management method categories are shown in the table below:

Risk categories:	**Group 1**	**Group 2**	**Group 3**	**Group 4**	**Group 5**
Products and services	3	3	3	2	1
Geographical location and payment traffic	3	1	3	2	2
Clients	3	2	3	2	2
Distribution channels	3	2	3	2	2
Risk level of risk categories:	**3**	**2**	**3**	**2**	**2**
Management method categories	**Group 1**	**Group 2**	**Group 3**	**Group 4**	**Group 5**
Risk-based approach	3	4	3	3	3
Organisation of activities	2	3	2	2	2
Customer due diligence	3	3	3	3	3
Monitoring	3	4	3	3	3
Risk level of management method categories:	**3**	**4**	**3**	**3**	**3**
Overall risk level, subsectors	**3**	**3**	**3**	**2**	**2**
Overall risk level, entire sector	**3**				

Sections 3.2 and 3.3 below review in more detail the justifications for each category's risk level.

3.2 Risk categories

3.2.1 Products and services

The products and services provided play a decisive role in the risk of a sector or individual entity being exploited in money laundering. The risk level of products and services was therefore weighted in the assessment more than the other categories.

A starting point for the assessment of risks associated with products and services is the FIN-FSA's inherent risk assessment of money laundering and terrorist financing and the inherent risk levels determined therein for different products and services.

The inherent risk levels are as follows (scale presented above in chapter

Products and services, money laundering
Deposits
Cash services
Payment accounts
Money remittance
Execution and acquisition of payment transactions
Virtual asset services
Currency exchange
Payment instruments and e-money
Trade Finance
Home loans and other highly secured loans
Private banking services
Investment services (incl. funds)
Business loans and other financing
Safe deposit boxes
Consumer credit

Products and services, terrorist financing
Deposits
Cash services
Payment accounts
Money remittance
Execution and acquisition of payment transactions
Virtual asset services
Currency exchange
Payment instruments and e-money
Consumer credit
Home loans and other highly secured loans
Private banking services
Investment services (incl. funds)
Business loans and other financing
Trade Finance
Safe deposit boxes

As stated in the summary of the FIN-FSA's inherent risk assessment, the greatest risk from the perspective of both money laundering and terrorism financing relates to products and services enabling the entry of funds into the legitimate payment system, their custody and their rapid transfer, if necessary, across borders. In practice, a very significant inherent risk is associated with various payment services.

Credit institutions belonging to groups 1-3 offer a wide range of services and, in practice, all of them offer services of very significant risk, i.e. various payment services. Of the payment services, only money remittance is offered to a very limited extent. The services of groups 1 and 3 are slightly more diverse than those of group 2 credit institutions, and they offer a greater variety of different products and services related to foreign trade, for example. In practice, services related to virtual assets are not offered at all.

Group 4 credit institutions offer a significantly narrower range of services. The services offered are mainly restricted to various loan products (incl. credit cards) to both private and corporation customers. Various payment services are offered on a limited basis.

Group 5 credit institutions have been separated into their own subsector precisely for reasons related to products and services. These credit institutions offer very limited services to a limited customer base. For example, some do not offer deposit or payment services at all.

3.2.2 Geographical risk

The assessment of geographical risk has taken into account, among other things, factors such as where services are provided and to which geographical regions payment traffic is directed.

The geographical risk is relatively higher for credit institutions in groups 1 and 3, as they provide services to a wider geographical area, for example through branches, or they have made notifications about providing services in the EEA area. Group 2 credit institutions operate mainly in Finland and thus their geographical risk is, in principle, lower. From the perspective of payment traffic, there is also a difference between group 2 credit institutions and group 1 and 3 credit institutions.

A significant proportion of group 4 credit institutions are branches of foreign credit institutions, which has the effect of increasing geographical risk compared with purely national entities. Group 5 refers to branches of foreign credit institutions, which naturally have international links.

3.2.3 Customer risk

The assessment of customer risk has taken into account the relative and absolute shares of the different customer groups reported by credit institutions in RA reporting. Such customers include foreign customers, high-risk customers and PEP customers.

Customer risk at the sector and subsector level can be assessed only at a very general level, as there may be large differences between credit institutions belonging to the same subsector in the relative and absolute number of customers belonging to certain customer groups.

Groups 1 and 3 credit institutions have both absolutely and relatively more foreign customers than group 2 credit institutions. Group 4 credit institutions have very limited numbers of foreign customers.

In RA reporting, credit institutions have been requested to report the number of customers they classify as high-risk customers. Based merely on the answers given, however, it is difficult, in practice, to assess the risk related to customers. Some credit institutions have reported very few high-risk customers.

However, in light of the answers given, it remains unclear whether the low number of high-risk customers is due to the fact that there are few high-risk customers or that the credit institution does not have appropriate procedures for identifying high-risk customers.

3.2.4 Distribution channels

The assessment of risks associated with distribution channels takes into account factors related to transaction channels and factors related to credit institutions' correspondent relationships.

Factors related to transaction channels include, for example, remote transaction and the practices followed therein, transaction at physical service points, and the use of agents and representative offices.

Forming a subsector-level assessment of distribution channel risk is difficult, as within subsectors there are large differences between credit institutions in how services are provided and in which channels. Different transaction channels also have elements that both increase and decrease risk. The use of remote identification may increase risk if appropriate procedures are not in place to verify identity. Use of strong electronic identification, on the other hand, is comparable, in principle, to personal physical transactions. Decentralising the provision of services to several different physical locations may increase the risk that different operating locations have different practices and that common guidelines are not adequately followed. Similar challenges are also associated with the use of agents. In simplified terms, the lowest distribution channel risk is associated with those credit institutions that handle customer relationships personally at one location.

The assessment emphasises the information reported by credit institutions in RA reporting. In groups 3 and 4, there are many credit institutions that base their activities purely on remote transactions and do not necessarily meet the customer in person at any stage of the customer relationship. Group 1 credit institutions use remote identification, but they also still have a comprehensive branch network. Group 2 credit institutions have used very little remote identification for initial identification and they also have many physical service points.

Most of the correspondent relationships are the correspondent relationships of group 1 credit institutions. Group 2 and 3 credit institutions have significantly fewer correspondent relationships, and they are geographically located mainly in the EEA – with a few individual exceptions. In group 4, there are very few correspondent relationships.

3.3 Management method categories

The purpose of this section on management methods is to form an understanding of the level of credit institutions’ money laundering and terrorist financing risk management methods.

The primary information source is the answers given to the questions on management methods in RA reporting. However, the information reported in RA reporting is information self-reported by supervised entities and does not as such necessarily give a true picture of how the management measures actually work. Therefore, with regard to management methods, the risk assessment has taken into account, among other things, the findings of ongoing supervision (incl. supervisor’s assessments) and inspections. As an assessment of management methods by subsector is involved, it is also necessary to assess the impact of findings made during the supervision of individual supervised entities on the assessment of the entire subsector’s management methods.

If there are no findings on the state of a subsector's management methods made within the scope of ongoing supervision and inspections, the assessment has to be on the basis of information provided by RA reporting. This applies particularly to groups 4 and 5. In these situations, a risk level has first been determined based on information from RA reporting. Thereafter, an expert assessment has been made on the extent to which the risk level based on the answers given to the questions in RA reporting probably corresponds to the state of affairs in the subsector. The expert assessment may be affected, for example, by the fact that, in the subsectors from which supervisory findings have been obtained, the actual state of management methods is weaker than the assessment made on the basis of information provided by RA reporting. In that case, it can be roughly assumed that the situation in other subsectors would also be weaker than what the answers given to the questions in RA reporting suggest.

3.3.1 Risk-based approach

In the assessment of the risk-based approach, attention is focused on whether the risks of money laundering and terrorist financing have been assessed sufficiently extensively and how the results of the risk assessment affect compliance with obligations regarding customer due diligence.

Groups 1-3 have mainly reported via RA reporting that they have risk assessments that take into account different subareas and that customers are classified into risk categories, which are taken into account when services are provided.

In connection with supervisory measures, however, large differences have been observed in how comprehensive the risk assessments prepared by credit institutions are and how well the risk assessments are actually taken into account, for example when preparing customer due diligence measures and complying with these measures.

Group 4 credit institutions have also reported that they take into account in their risk assessments risk related to different subareas. Some have reported that the monitoring system does not take into account the customer's risk category.

3.3.2 Organisation of activities

In the assessment of the organisation of activities, attention has been paid to whether the functions to prevent money laundering and terrorist financing exist as required by law and how they work in practice.

With regard to the answers given in RA reporting, no significant shortcomings can be observed for any subsector. In the supervision of credit institutions in groups 1-3, however, it has been observed that the division of tasks between different functions is not always clear in practice and that there are challenges in the flow of information between different functions. In addition, particularly in the case of smaller credit institutions, it has been observed that insufficient resources have been allocated to the functions. With regard to group 4 credit institutions, in the absence of supervisory findings, it has been assessed that corresponding shortcomings probably also exist within this category.

3.3.3 Customer due diligence

The assessment in relation to customer due diligence focuses on compliance with customer due diligence obligations. The assessment is impacted by whether the credit institutions have put in place processes related to customer due diligence as required by law (e.g. enhanced customer due diligence and related procedures) and, on the other hand, how the obligations are complied with in practice. In the assessment, the answers given in RA reporting as well as supervisory findings have been utilised.

Based on the answers given in RA reporting, there are no significant shortcomings in the credit institution sector with regard to procedures for complying with the customer due diligence obligation.

In connection with supervisory measures, it has been repeatedly found, however, that group 1-3 credit institutions have had challenges in updating customer due diligence. Shortcomings have also been found in the risk classification of customers, such that the risk categories do not, for example, correspond to the results of a credit institution's risk assessment. In supervision, shortcomings have also been found in how credit institutions' own procedural guidelines are applied in practice. With regard to group 4 credit institutions, in the absence of supervisory findings, it has been assessed that corresponding challenges probably also exist within this group.

3.3.4 Monitoring

The section on monitoring assesses how ongoing monitoring of the customer has been arranged and how the reporting obligation to the Financial Intelligence Unit (FIU) is realised. In the assessment of monitoring, attention has also been paid to the extent to which credit institutions report suspicious transactions internally and the extent to which they submit notifications to the FIU.

Credit institutions in group 1 and 3 mainly use system-based monitoring, which reduces the amount of manual work and enables the monitoring of large numbers of customers and transactions. Group 2 credit institutions have worked to develop monitoring systems, but some of the processes still include laborious manual steps. Based on the answers given in RA reporting, most group 4 credit institutions use system-based monitoring to monitor payment traffic.

There are large differences between different credit institutions with regard to the number of scenarios in monitoring systems. By scenarios is meant a set of parameters used in monitoring which, when they are fulfilled, result in the system producing a hit. A lower number of scenarios increases the amount of manual work in investigating hits produced by the system, and manual work slows down the submission of notifications to the FIU. A low number of scenarios may also be a sign that ongoing monitoring is inadequate, taking into account the credit institutions' numerous products and services as well as customer groups.

There is also a broad spread among credit institutions with regard to the extent to which they submit notifications to the FIU. Even in terms of the quality, size and scope of activities, there are big differences between comparable credit institutions. The notification activity of group 4 credit institutions, in particular, is weak. There are also big differences in the extent to which notifications that result in an internal investigation are forwarded to the FIU. If a large proportion of notifications that result in an internal investigation are forwarded to the FIU, the suspicion arises as to whether the system is accurate enough. On the other hand, if the number of notifications forwarded to the FIU is very small compared with internal notifications, the monitoring system may be unnecessarily strict, causing extra manual work. Credit institutions also take quite a long time to submit notifications of monitoring hits, which raises concerns about whether notifications will be made promptly as required by law.

4 Targeting of supervision

Based on the risk assessment, supervisory measures will be targeted particularly at group 2 credit institutions in order to ascertain at what the level the risk management methods actually are. With regard to group 1 credit institutions, ongoing supervisory measures will be actively continued, for example within the framework of international AML/CFT colleges of supervisors. With regard to group 3, there will be active participation in the Supervisory Review and Evaluation Process (SREP) of domestic credit institutions. With regard to branches of foreign credit institutions, it has been considered necessary to obtain additional information of risks related to management methods. For groups 4 and 5, the goal is to obtain additional information on the quality and scope of activities and risk management methods with the aid of RA reporting as well as through possible targeted surveys before updating the sector-specific risk assessment.