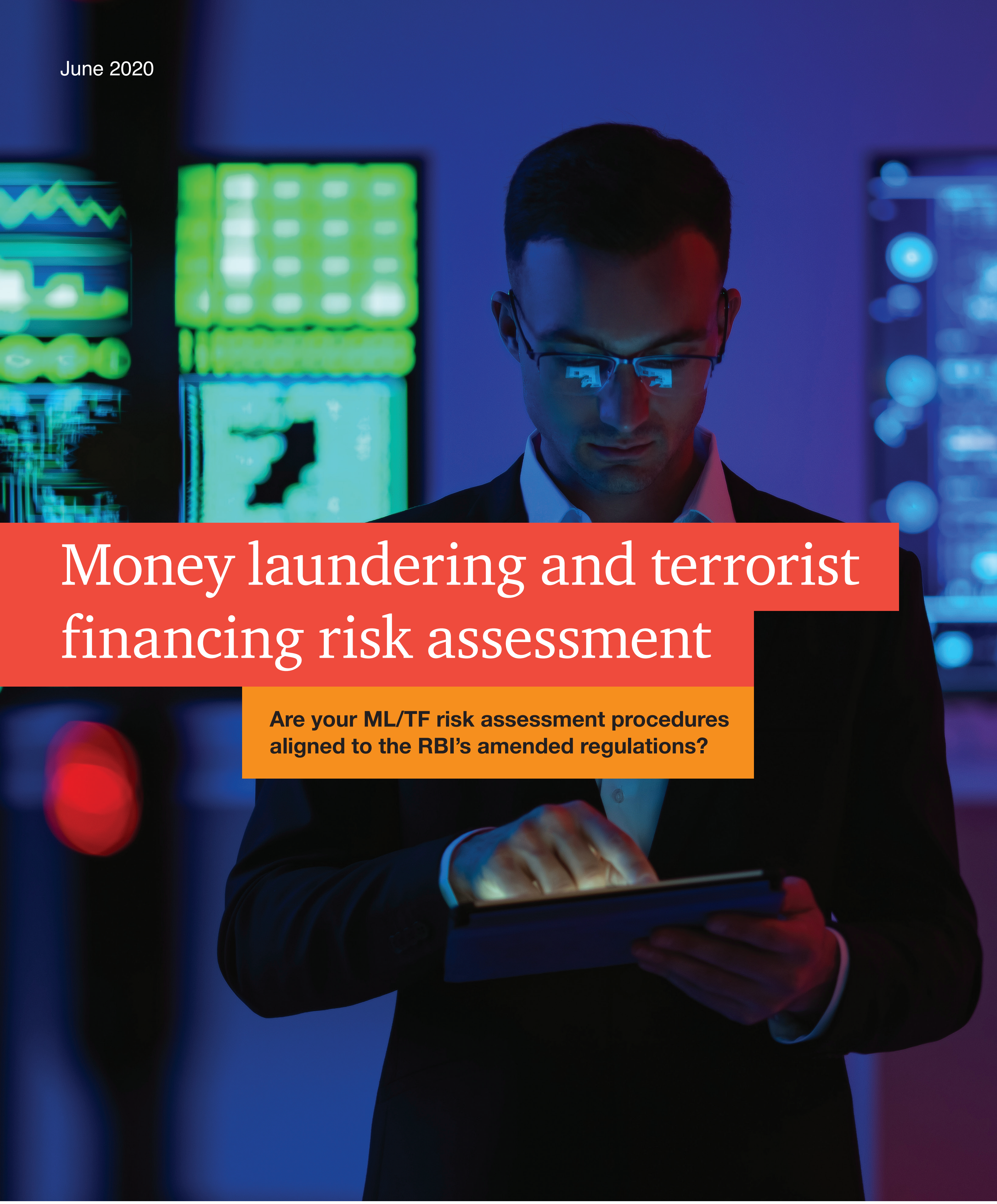

June 2020

Money laundering and terrorist financing risk assessment

Are your ML/TF risk assessment procedures aligned to the RBI's amended regulations?

The new regulatory requirements

The Reserve Bank of India (RBI) issued an amendment in April 2020 on money laundering (ML) and terrorist financing (TF) risk assessment. It requires financial institutions (FIs) to enhance their existing risk assessment approach by using a holistic risk-based approach and include risk factors other than the customer-specific ones. Currently, the RBI expects FIs to complete this exercise by 30 June 2020.

What has changed?

FIs have been using customer risk rating (CRR) as a focal point of their ML and TF risk assessment and compliance programmes. With the amendment to the Master Direction on know your customer (KYC) by the RBI, FIs are required to **enhance** the list of factors they have been using to perform CRR. Channel of delivery and sectoral risks are some of the parameters that will have to be assessed and included in the CRR. FIs would also be required to use a risk-based approach to consider risks at the **business unit** (BU) level and incorporate them in the overall ML/TL risk.

Illustrative risk factors

Client: Customer type, legal form of the customer and employment status

Geography: Nationality, residence country, country of incorporation, place of business and operations

Product and services: Value and size of the product, cash-intensive nature and transparency of the product

Transaction: Parties involved in the transaction, simple or complex nature of transaction and value

Delivery channels: Intermediaries involved and non face-to-face customers

Other factors: Expected client growth, integration of information technology (IT) systems, internal audit findings, new products or technology, etc.

A few important questions for the compliance team to address

Do you utilise a risk-based approach in assessing your ML/TF risk?

Is your approach customer risk centric or do you use an enterprise-wide level methodology to arrive at the ML/TF risk?

What are the factors that you consider while assessing the ML/TF risk? Do you account for business/sector and delivery channel risks in your assessment?

How frequently do you review your risk assessment methodology?

Is your risk assessment commensurate to the size of your business, complexities and activities?

Impact of the amendment

As FIs adapt to this new amendment for assessing ML/TF risks, it is very important to understand the impact of this change, as it will not only modify risk assessment models or methodologies, but is also expected to have an overall impact on business, customers, monitoring systems and operations. Some of the expected changes have been highlighted below.

Customer risk rating and business

The method to assess customer risk rating (CRR) will get impacted. A few potential implications of this are as follows:

- All CRRs will have to be reassessed using the new model.
- If the CRR does change, then FIs will have to revisit the products and services that are being provided to the customer.
- Additional due diligence measures (enhanced due diligence, re-KYC) may have to be performed if the CRR changes from medium to high.
- In some cases, the FIs might have to re-evaluate their relationship with the customer.

Monitoring and operations

As risks will be evaluated at the enterprise level, new typologies and scenarios from an ML/TF perspective will have to be identified and incorporated into the monitoring systems. Some of the potential implications of such a method are:

- enhancing the existing monitoring systems to include additional scenarios
- redoing customer segmentation
- changing of the volume and variety of alerts that get generated, and
- training of compliance staff on the new scenarios or typologies identified.

Risk assessment approach

The approach to risk assessment will need to utilise a risk-based approach at the enterprise level (enterprise-wide risk assessment [EWRA]). At a practical level, this means that there will be more factors relevant to risk assessment.

As the traditional static customer-centric models will no longer be effective in complying with the regulatory guidance, FIs will need to evaluate dynamic risk rating (DRR) methodologies and determine the best ways to implement them in the overall compliance programme. This will allow FIs to be compliant and help them effectively manage the dynamic nature of risks.

How PwC can help

It is clear that the latest amendment by the RBI requires an approach that is different from the one used traditionally. While this approach requires intervention from risk and compliance departments, it also requires business, operations and technology teams to play an integral role as they are impacted as well. Further, as this amendment requires adoption of a risk-based approach at the enterprise level, utilising a dynamic risk assessment model is the preferred approach.

PwC has extensive experience in designing and implementing EWRA models that incorporate the concepts of a risk-based approach. This, coupled with our in-depth knowledge of anti-money laundering and terrorist financing risk assessment, provides us with the right experience to understand the full impact of the RBI's amendment. We can assist FIs in preparing and implementing a plan to operationalise the enhanced ML/TF risk assessment methodology, and ensure that the new approach is fully embedded in the compliance programme and the overall business strategy.

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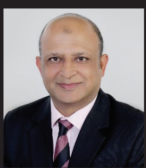
If you would like a better understanding of how you can strategise and implement this new approach, please contact us.



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