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# Consultation Paper

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## Draft Guidelines

on the characteristics of a risk-based approach to anti-money laundering and terrorist financing supervision, and the steps to be taken when conducting supervision on a risk-sensitive basis under Article 48(10) of Directive (EU) 2015/849 (amending the Joint Guidelines ESAs 2016 72)

The Risk-Based Supervision Guidelines

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# 1. Responding to this consultation

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The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

## **Submission of responses**

To submit your comments, click on the ‘send your comments’ button on the consultation page by 17 June 2021. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

## **Publication of responses**

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA’s rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA’s Board of Appeal and the European Ombudsman.

## **Data protection**

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EU) 1725/2018 of the European Parliament and of the Council of 23 October 2018. Further information on data protection can be found under the Legal notice section of the EBA website.

## 2. Executive Summary

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Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing entered into force on 26 June 2015. The Directive aims, inter alia, to bring European Union legislation in line with the International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation, published by the Financial Action Task Force (FATF), a setter of international standards on anti-money laundering/combating the financing of terrorism (AML/CFT). It puts the risk-based approach at the center of Europe's AML/CFT regime and recognises that the risk of money laundering (ML) and terrorist financing (TF) can vary. It requires Member States, competent authorities and obliged entities to take steps to identify and assess that risk with a view to deciding how best to manage it.

In accordance with Article 48(10) of Directive (EU) 2015/849, the EBA is required to issue guidelines to competent authorities on the characteristics of a risk-based approach to AML/CTF supervision (RBS). The first iterations of the guidelines was published in 2016 as joint guidelines, as all three European Supervisory Authorities (ESAs) held AML/CFT mandates at the time. They set out steps that supervisors should take when conducting AML/CFT supervision on a risk-sensitive basis. With these guidelines, the ESAs aimed to create a common understanding of the risk-based approach to AML/CTF supervision and to establish consistent and effective supervisory practices across the EU, which are consistent with international standards.

There have since been a number of reports that considered the extent to which competent authorities have implemented an effective, risk-based approach to AML/CFT supervision. These include the publication of the EBA's report on competent authorities' approaches to AML/CFT supervision of banks (EBA/Rep/2020/06, the 'EBA report') in February 2020, the publication of the post-mortem report by the European Commission and the publications of the ESAs Joint Opinion on risks under Article 6(5) in October 2019, which all raised concerns about the adequacy and effectiveness of some competent authorities' approaches to the AML/CFT supervision. The EBA assessed these reports and concluded that there was a need for further guidance on this topic to ensure effective AML/CFT supervision going forward. To that end, the EBA concluded that it was necessary to revise the guidelines.

The proposed amendments address the key challenges for supervisors when implementing the risk-based approach. They also take into consideration changes in the EU legal framework that came into force since the guidelines were first issued and new international guidance by the FATF and the Basel Committee on Banking Supervision on this topic. In summary, the revised guidelines:

- emphasise the need for a comprehensive risk assessment at a sectoral and sub-sectoral level to support competent authorities' identification of those risk areas that require more intense supervisory attention;
- explain different supervisory tools available to competent authorities and provide guidance on selecting the most effective tools for different purposes;
- emphasise the importance of a robust follow-up process and set out different aspects that competent authorities should consider when determining the most effective follow up action;

- provide further guidance on the implementation of a robust supervisory strategy and plan, to ensure that competent authorities allocate their supervisory resources according to the risk exposure of subjects of assessment under their supervision;
- clarify competent authorities' obligations as regards to the AML/CFT supervision of groups and emphasise the need for competent authorities, that are responsible for the supervision of the group's head office, to develop a good understanding of ML/TF risks to which the group is exposed with a view to ensure that group-wide policies and procedures are implemented effectively;
- highlight the importance of cooperation among competent authorities and between competent authorities and other stakeholders including prudential supervisors, the FIU, tax authorities, law enforcement and AML/CFT authorities in third countries. In particular, the guidelines recognise that supervisory cooperation is important not only when supervising cross-border groups, but also in respect of domestic groups and subjects of assessments.
- provide further guidance on how competent authorities can determine the type of guidance needed within the sector and how to communicate this guidance in the most effective manner;
- include further clarifications on the type of training that the competent authorities should provide to their staff.

The original guidelines were developed by the Joint Committee of the three European Supervisory Authorities (ESAs). However, this Consultation Paper has been developed by the EBA only because, since the entry into force of revised Regulation (EU) 2019/2175 on 1 January 2020, the other two ESAs, ESMA and EIOPA, no longer have direct responsibility for AML/CFT.

## Next steps

The amended guidelines are published for a three-months public consultation where the EBA is consulting only on changes to the existing Risk-based Supervision Guidelines. There is no consultation on the text of the original guidelines that has not changed.

The EBA will finalise these guidelines once the consultation responses have been assessed. Upon publication of the final Guidelines, the original Risk-based supervision Guidelines will be repealed.

## 3. Background and rationale

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### 3.1 Background

1. Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing aims, inter alia, to bring EU legislation in line with the International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation that the Financial Action Task Force (FATF), an international AML/CFT standard setter, adopted in 2012.
2. In line with the FATF's standards, the Directive puts the risk-based approach at the center of Europe's anti-money laundering and countering the financing of terrorism (AML/CFT) regime. It recognises that the risk of money laundering (ML) and terrorist financing (TF) can vary and that Member States, competent authorities and obliged entities have to take steps to identify and assess that risk with a view to deciding how best to manage it. Consequently, under a risk-based approach, competent authorities should allocate their AML/CFT supervisory resources in a risk-sensitive way in order to exercise their responsibilities more effectively.
3. Directive (EU) 2015/849 requires competent authorities to monitor effectively, and to take the measures necessary to ensure compliance with the Directive. As part of this, it requires competent authorities to adjust the frequency and intensity of onsite and offsite supervision to reflect the outcomes of their ML/TF risks assessments. In accordance with Article 48(10) of Directive (EU) 2015/849, the EBA is required to issue guidelines to competent authorities on the characteristics of a risk-based approach to AML/CTF supervision.
4. To that end, the guidelines on the characteristics of a risk-based approach to anti-money laundering and terrorist financing supervision, and the steps to be taken when conducting supervision on a risk-sensitive basis (ESAs 2016 72) under Article 48(10) of the Directive (EU) 2015/849 (the 'Original Guidelines') were first published on 16 November 2016 as joint guidelines, as all three European Supervisory Authorities (ESAs) held AML/CFT mandates at the time. In the Original Guidelines, the ESAs characterised the risk-based approach to AML/CFT supervision as an ongoing and cyclical process that consists of four steps, namely the identification of ML/TF risk factors; the assessment of ML/TF risks; the allocation of AML/CFT supervisory resources based on the outcomes of this risk assessment, including decisions on the focus, depth, duration and frequency of onsite and offsite inspections, and on supervisory staffing needs; and the monitoring and review of their risk based supervision model, including the risk assessment and the underlying methodology. With these Original Guidelines, the ESAs aimed to create a common understanding of the risk-based approach to AML/CTF supervision and to establish consistent and effective supervisory practices across the

EU, which are consistent with international standards. All competent authorities have indicated that they complied, or intended to comply, with the Original Guidelines.

5. Since the publication, various reviews of competent authorities' implementation of these guidelines have found that supervisors are finding it challenging to translate the theoretical understanding of the risk-based approach into practice. As a result, the reports found that AML/CFT supervision of credit institutions and financial institutions in the EU was not always adequate or effective. These reports include:

- Mutual Evaluation Reports by the FATF and Moneyval that have highlighted various shortcomings in the AML/CFT supervisory framework in some Member States. By February 2021, 15 out of 20 Member States that had been assessed in recent years were found to be 'moderately effective' in their AML/CFT supervision, with only two Member States assessed as having a 'substantive' level of effectiveness and three Member States as having a low level of effectiveness.
- The EBA's report on competent authorities' approaches to AML/CFT supervision of banks<sup>1</sup> (the 'EBA Report') published in February 2020, which highlighted that competent authorities' approaches to identifying and assessing ML/TF risk associated with the sector, and the ML/TF risk associated with individual banks under their supervision were often inadequate. This meant that often competent authorities in the EBA's sample were unable to target their supervisory resources on areas presenting the greatest ML/TF risk in their jurisdiction. In addition, some supervisors found it challenging to implement an effective supervisory strategy and plan, which meant that they did not supervise firms in a strategic or consistent way, with institutions in some sectors not being supervised at all.
- The ESAs' Joint Opinion on ML/TF risks published in accordance with Article 6(5) of Directive (EU) 2015/849 in October 2019, identified significant differences in the way the risk-based supervision was carried out by competent authorities across the EU. The ESAs considered that these differences may have significant implications for the robustness of the EU's AML/CFT defenses and for the integrity and stability of the overall financial sector. The ESAs explained that, based on information received from competent authorities, it was evident that most competent authorities focused their attention on sectors they considered to present significant ML/TF risks, while applying very little or no supervision to sectors perceived to be less risky. In this opinion, the ESAs also raised concerns about the quality and adequacy of risk assessments carried out by competent authorities, as they found that in some instances the assessment was based solely or largely on one risk factor.
- The European Commission's post mortem report on the assessment of recent alleged money laundering cases involving EU credit institutions<sup>2</sup> that was published on 24 July 2019 and in which the Commission identified many failures by competent authorities in the way they had supervised banks involved in recent money laundering scandals. Overall, the report highlights

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<sup>1</sup> <https://eba.europa.eu/eba-acts-improve-amlcft-supervision-europe>

<sup>2</sup> [https://ec.europa.eu/info/sites/info/files/report\\_assessing\\_recent\\_alleged\\_money-laundering\\_cases\\_involving\\_eu\\_credit\\_institutions.pdf](https://ec.europa.eu/info/sites/info/files/report_assessing_recent_alleged_money-laundering_cases_involving_eu_credit_institutions.pdf)

that in most cases competent authorities had failed to identify risks and had failed to choose adequate tools to supervise those risks and to apply robust supervisory measures when breaches were identified.

- The EBA published a report on competent authorities' approaches to tackling ML/TF risk associated with illicit dividend arbitrage trading schemes and found that not all competent authorities had the same understanding of dividend arbitrage trading schemes, due to differences in Member States' domestic tax laws, which meant that proper considerations were not given to incorporating risk associated with tax crimes in the competent authorities' risk assessments. The EBA also adopted a cum-ex action plan<sup>3</sup> in April 2020, where it recommended the Risk-based supervision guidelines to include additional requirements on how AML/CFT competent authorities should identify, assess and address ML/TF risks associated with tax crimes and clarify how AML/CFT supervisors and tax authorities should cooperate, in line with changes introduced by Directive (EU) 2018/843.
  - The European Council's AML/CFT Action plan published in December 2018 identified a number of shortcomings in supervisors' approaches to tackling ML/TF risk and called on the EBA action to strengthen AML/CFT supervision in the EU, including by revising the ESAs Risk-based Supervision Guidelines.
6. Against this background, the EBA concluded that there was a need for further guidance on this topic to ensure effective AML/CFT supervision going forward by making changes to the existing ESAs Risk-based Supervision Guidelines. The revised guidelines build on the existing 4-step approach to the supervision and enhance the existing or introduce additional guidance on aspects that have been identified as causing the most challenges for competent authorities as set out below. The revised guidelines take into account the recent international guidance in the area of AML/CFT, including the development of the Risk-based Supervision Guidelines by the FATF and the existing Basel Committee guidelines on this topic.
7. In addition, the revised guidelines address changes introduced by Directive (EU) 2018/843, which entered into force on 9 July 2018 and amended the Directive (EU) 2015/849, whereby the directive highlights the need for cooperation between competent authorities and with other stakeholders, including prudential supervisors and Financial Intelligence Units. To that end, the revised guidelines recognise the links with other EBA's and ESAs' guidelines, including the ESAs Joint Guidelines on Cooperation and information exchange for the purpose of Directive (EU) 2015/849 between competent authorities supervising credit and financial institutions (JC 2019 81) and the EBA's Guidelines on Cooperation and information exchange between prudential supervisors, AML/CFT supervisors and Financial Intelligence Units under Article 117(6) of Directive 2013/36/EU, which are currently being developed and will be published for consultation in the first part of 2021.
8. Furthermore, the revised guidelines aim to address concerns raised in response to the EBA's Call for Input, which aimed to develop better understanding of the impact of de-risking on credit and

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<sup>3</sup> <https://eba.europa.eu/eba-publishes-its-inquiry-dividend-arbitrage-trading-schemes-%E2%80%9Ccum-excum-cum%E2%80%9D-and-announces-10-point>



financial institutions and on individuals, by explaining what competent authorities should do to reduce the risk of de-risking or current and potential customers by some sectors.

## 3.2 Rationale

9. The Original Guidelines were developed by the Joint Committee of the three European Supervisory Authorities (ESAs) on 21 October 2016. However, this Consultation Paper has been developed by the EBA only because, since the entry into force of Regulation (EU) 2019/2175 on 1 January 2020, the ESAs' AML/CFT mandate was consolidated in the EBA.

10. This chapter explains the rationale for the amendments and additions that the EBA propose to make to the original version of the guidelines to address the new EU legislative framework and new risks. The scope of the consultation, and of the consultation questions, is therefore limited to those amendments and additions, and does not include guidance that the EBA has left unchanged and that had already been consulted on during the development of the Original Guidelines.

11. In addition, the EBA has made a number of changes that are non-substantive and of a presentational and structural nature. For example, the numbering for paragraphs has been replaced with a numbering of guidelines and the references to titles have been removed. Also, the text has been removed, which merely re-produced Level-1 text.

12. However, the key principles underlying the Original Guidelines have not changed:

- The revised guidelines have not made changes to the basic concepts and a 4-step approach to supervision developed by the ESAs in the Original Guidelines, which consist of the identification of ML/TF risk factors, assessment of the ML/TF risks, supervision of obliged entities and sector and monitoring and review of the risk based supervision model. This means that the risk-based supervision should be based on the ML/TF risk assessment carried out by competent authorities.
- The guidelines acknowledge that some credit institutions and financial institutions may share the same characteristics and the level of risk. This means that it may be more effective to treat these credit institutions and financial institutions by competent authorities as one subject of assessment.
- The guidelines recognise that the same level and intensity of supervision is not required in respect of all credit institutions and financial institutions and that supervision should be adjusted in line with the ML/TF risk exposure of the sector and subjects of assessment.
- The guidelines recognise the national differences when transposing of Directive (EU) 2015/849 into their national laws, which means that a complete convergence in terms of supervision across the EU is not always possible.

### 4.2.1 Amendments to the 'Subject matter, scope and definitions'

13. The revised Guidelines in paragraphs 5 to 8 propose to revise paragraphs 1 to 4 of the Original Guidelines by making various non-substantive changes to the ‘subject matter, scope and definitions’ section to align the Original Guidelines, which were developed by the Joint Committee of three ESAs, with the EBA’s drafting requirements. This includes the proposal to remove paragraph 8 of the Original Guidelines and insert this paragraph in a new section titled ‘Addressees’ in paragraph 9 of the revised guidelines.

14. In addition, the EBA propose to revise paragraph 4 of the Original Guidelines as follows:

- a) The definition of ‘Cluster’ has been revised to clarify that competent authorities may decide to treat two or more credit institutions or financial institutions as one cluster where those credit or financial institutions share similar characteristics and are exposed to the same levels of ML/TF risk. The EBA has removed a reference to ‘group of subjects of assessments’ from the definition of ‘cluster’ to clarify that the cluster can be treated as a subject of assessment as set out in the definition of ‘subjects of assessment’.
- b) The definition of ‘Competent authority’ is removed as it was deemed redundant in light of the inclusion of a new section titled ‘Addressees’ in the guidelines, which clearly sets out who the competent authorities are.
- c) The definition of ‘Firm’ has been replaced throughout the guidelines with ‘credit institutions and financial institutions’ as this term is defined in Directive (EU) 2015/849.
- d) The definition of ‘Inherent money laundering/ terrorist financing (“ML/TF”) risk’ has been amended so that it refers to the ‘Inherent risk’. In addition, the definition clarifies that the inherent risk refers to the ML/TF risk in the subject of assessment and sector before the application of the mitigating measures.
- e) In the definition of ‘Risk-based approach (RBA)’, the term ‘obliged entities’ has been replaced with subjects of assessment to reflect the notion of clusters that imply that some ‘obliged entities’ can be grouped together when applying the RBA.
- f) The definition of ‘Risk-based AML/CFT supervision (RBS)’ has been removed as it is described in detail in these guidelines and in Directive (EU) 2015/849.
- g) In the definition of ‘RBS Model’ the reference to practicalities has been removed as the definition already contains references to ‘processes and procedures’.
- h) The definition of ‘ML/TF risk’ has been revised to avoid duplication with a separate definition that defines the term ‘inherent risk’.
- i) The definition of ‘Risk profile’ has been revised to clarify that the risk profile may be developed for subjects of assessment and also for sectors/sub-sectors. The definition also clarifies that the risk profile is not limited only to the residual risk, as it was suggested in the existing guidelines, but may also be based on inherent risk, where, for example, the information on mitigating measures is not available to the competent authority at the time.
- j) The definition of ‘Subject of assessment’ has been revised by removing a reference to sectors and sub-sectors in order to distinguish the steps that should be taken by competent authorities in respect of sectoral and sub-sectoral risk assessments from the step they should take in respect of credit and financial institutions. A reference to ‘group’ was removed from the definition to avoid possible confusion with the concept of ‘clusters’.
- k) The definition of ‘Threat’ was adjusted slightly to remove the general explanation of what is a threat and to make it more relevant for the application in an AML/CFT environment. Also, a reference to ‘their funds’ was removed from the definition.

- l) Definitions of ‘Ad hoc inspection’, ‘AML/CFT returns’, ‘Follow up inspection’, ‘Full-scope on-site inspection’, ‘Off-site review’, ‘Emerging risk’, ‘De-risking’, ‘Residual risk’, ‘Supervisory tools’, ‘Thematic inspection’ have been added to the guidelines. Definition of these terms were deemed necessary to foster convergence of approaches by competent authorities as all these terms are widely but inconsistently used by competent authorities across the EU.

**Question 1: Do you have any comments with the proposed changes to the ‘Subject matter, scope and definitions’? Please note that only comments in respect of the changes can be considered.**

#### 4.2.2 Amendments to Guideline 4.1: Implementing the RBS model

15. In accordance with the Original Guidelines, competent authorities are required to implement a supervisory model, which is based on their risk assessment of sectors and subjects of assessment. The risk-based supervision model (the RBS model) involves four steps: the identification of risk factors, the assessment of the ML/TF risks, the supervision of subjects of assessment and the monitoring and review of the model. However, the EBA Report recognised that some of these steps were interpreted and applied inconsistently by competent authorities across the EU when trying to implement them in practice. Therefore, the revised guidelines propose to set out additional guidance for competent authorities on each of the steps to ensure that the RBS model is developed and implemented effectively across all sectors and across the EU.

16. In addition, the guidelines have been revised to emphasise the importance of cooperation among competent authorities and with other authorities responsible for the supervision of credit and financial institutions. This follows the European Commission’s Post-Mortem Report, which identified limited cooperation between competent authorities and with prudential supervisors as one of the factors contributing to the various failures to implement robust AML/CFT frameworks by some of the European banks.

17. In terms of substance, the EBA proposes to amend Guideline 4.1 as follows:

- a) Guideline 4.1 paragraph 11 is based on paragraph 5 in the Original Guidelines. Paragraph 5 has been revised to align it with a structural change in the risk based supervision whereby supervisory follow up and feedback to the sector are supervisory activities that are now considered to be part of Step 3 in the RBS model. Therefore the reference to the ‘follow up’ has been removed from Step 4.
- b) Guideline 4.1 paragraph 13 is a new guideline and it clarifies the application of general conditions set out in paragraphs 11 and 12 in the draft guidelines.
- c) Guideline 4.1 paragraph 14 is based on paragraph 10 in the Original Guidelines. Paragraph 10 has been revised to clarify that the extent of competent authorities’ supervisory actions should be commensurate to the ML/TF risk and should not be determined on the basis of the nature and size of the subject of assessment. The reference to the ‘nature and size of the subject of assessment’ has therefore been removed from paragraph 10.
- d) Guideline 4.1 paragraph 15 is based on paragraph 11 in the Original Guidelines. The term ‘firms’ in paragraph 11 has been replaced with the term ‘credit institutions and financial institutions’ to address the changes in definitions.

18. In terms of substance, in relation to subjects of assessment, the EBA proposes to amend Guideline 4.1 as follows:

- a) Guideline 4.1 paragraph 16 is based on paragraph 7 in the Original Guidelines. This guideline explains how competent authorities can determine clusters and it sets out the characteristics that may suggest that certain credit institutions or financial institutions may be grouped together in one cluster. This means that the risk-based approach can then be applied at a cluster level, instead of individual subjects of assessment. Paragraph 7 has therefore been revised to incorporate the amendments to definitions and to emphasise the fact that one of the key characteristics that should be present when determining a cluster is the exposure to the same level of ML/TF risk by credit institutions or financial institutions in one cluster.
- b) Guideline 4.1 paragraph 17 is a new guideline. It sets out the type of information and the sources of that information that competent authorities should refer to when identifying credit institutions or financial institutions that may belong to the same cluster.
- c) Guideline 4.1 paragraph 18 is based on paragraph 8 in the Original Guidelines. Paragraph 8 has been revised to emphasise the fact that domestic credit institutions or financial institutions in the same sector that form part of a group should not be clustered but instead should be treated as one subject of assessment.
- d) Guideline 4.1 paragraph 19 is based on paragraph 9 in the Original Guidelines. This guideline explains circumstances in which competent authorities are required to re-assess whether a particular credit institutions or financial institutions continue to share the same characteristics as other credit institutions or financial institutions in the cluster. Where this is no longer so, the guideline requires competent authorities either to remove that credit institution or financial institution from the cluster and treat it as an individual subject of assessment or to move it to a different cluster with the same characteristics. Paragraph 9 has been revised to incorporate the amendments to definitions. Also, in order to ensure a better flow of information, the specific factors that may indicate that de-clustering may be needed, have been moved from within the paragraph as in the Original Guidelines to the end in the new draft guidelines. In addition, the guidelines provide some clarification in relation to the conditions that may suggest the need for de-clustering. These include the clarification that:
  - deficiencies in the internal control framework may have an impact on credit institutions' or financial institutions' residual risk rating,
  - where there are doubts about the beneficial owner's integrity that those doubts are based on ML/TF concerns;
  - significant changes in the products or services offered by credit institutions or financial institutions may suggest that their risk profile has changed and they might no longer share the same characteristics with the cluster.

### Cooperation

19. In terms of substance, in relation to cooperation, the EBA proposed to amend Guideline 4.1 as follows:

- a) Guideline 4.1 paragraphs 20 - 23 are based on paragraphs 12 and 13 in the Original Guidelines, which emphasises the need for cooperation and exchange of information between competent authorities and with other stakeholders to ensure the implementation of the effective RBS model. The revised guidelines contain the following changes in respect of cooperation:

- Paragraph 12 in the Original Guidelines, which is now Guideline 4.1 paragraph 20, has been revised and now includes examples of potential stakeholders that competent authorities should consider cooperating with.
- The revised guidelines are clear that competent authorities should assess what cooperation and coordination mechanisms they have already been put in place with various stakeholders and utilise those mechanisms for the purposes of the RBS model, where possible and necessary. To that end, paragraph 13 in the Original Guidelines, which is now Guideline 4.1 paragraph 21 has been revised to reflect the latest developments at the level of the EU in relation to cooperation. In particular, it makes references to various other ESAs and EBA guidelines as well as the Multilateral Agreement between competent authorities and the ECB, which clearly set out the practical modalities for cooperation between competent authorities and certain other stakeholders, like prudential supervisors, Financial Intelligence Units and AML/CFT supervisors in third countries. The draft guidelines also recognise that informal channels and personal relationships can support cooperation and information exchange but may present a continuity risk arising from personnel changes or fallouts, which means that the informal arrangements cease to function, leaving a potential information void. Competent authorities therefore should ensure that informal channels do not replace formal arrangements.
- Guidelines 4.1 paragraphs 22 and 23 are new. The draft guidelines explain that not all stakeholders may require the same level and extent of cooperation and information exchange. To determine the correct level, competent authorities should consider what is their objective for cooperating and exchanging information with these stakeholders. For example, if certain information is required as part of their supervision of a branch in their Member State, then competent authorities may need to have a regular exchange of information with the competent authority responsible for the supervision of the head office or make use of AML/CFT colleges where they exist. Also, cooperation with some stakeholders may be limited to the exchange of information on regular or ad hoc basis, whereas with others, it may also involve joint supervisory actions.

**Question 2: Do you have any comments with the proposed changes to the Guideline 4.1 'Implementing the RBS model'? Please note that only comments in respect of the changes can be considered.**

#### **4.2.3 Amendments to Guideline 4.2: Step 1- Identification of risk and mitigating factors**

20. As set out in the Original Guidelines, in order to implement their RBS model, competent authorities should start with identifying risk factors that affect their sectors and subjects of assessment. To inform their view of the relevant risk factors, competent authorities should refer to the EBA's AML/CFT Risk Factors Guidelines<sup>4</sup>. However, the EBA report identified weaknesses in this process, in particular that most competent authorities were using the same set of risk factors for all banks and, in some cases, for all financial institutions. In addition, as highlighted by both, the report and the 2019 Opinion on ML/TF risk, most competent authorities had not carried out the assessment of ML/TF risks at a sector level, which meant that their understanding of the risk factors associated

<sup>4</sup> Consultation Paper on the draft guidelines under Articles 17 and 18(4) of Directive (EU) 2015/849 on customer due diligence and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions (JC 2019 87)

with subjects of assessment was often inaccurate and did not appear to represent the current situation within the Member State. Therefore, the revised guidelines provide further clarifications on the need for sectoral risk assessments and the type of information and sources of information that competent authorities should use to identify the risk factors within sectors and subjects of assessment.

21. In terms of substance, the EBA proposes to amend Guideline 4.2 as follows:

#### General considerations

- a) Guideline 4.2. paragraph 24 is based on paragraph 14 in the Original Guidelines. Paragraph 23 has been revised by removing a reference to ‘when applying a RBS model’ as it was deemed redundant on a basis that the guidelines in their entirety explain how the RBS model should be applied, not just this paragraph. Also, the draft guideline clarifies that competent authorities are obliged to identify and understand the ML/TF risk factors for both, individual subjects of assessment and sectors.
- b) Guideline 4.2 paragraph 25 is based on paragraph 16 in the Original Guidelines. In paragraph 16, the reference to the ESAs Risk Factors Guidelines has been amended to reflect that the revised version of these guidelines is to be issued by the EBA in 2021.
- c) Guideline 4.2 paragraph 26 is based on paragraph 30 in the Original Guidelines. Paragraph 30 has been revised to reflect changes in the definition of ‘cluster’, which meant that the reference to ‘individual firms’ was removed from this paragraph. Also, a reference to paragraph 27 was replaced with a reference to paragraph 40 in the draft guidelines.
- d) Paragraph 30 of the Original Guidelines was removed from the revised guidelines.
- e) Guideline 4.2 paragraph 28 is based on paragraph 15 in the Original Guidelines and no changes have been made to the paragraph.

#### Sources of information

- f) Guideline 4.2 paragraph 29 is based on paragraph 17 in the Original Guidelines. In paragraph 17, a reference to ‘where possible’ has been deleted in order to clarify that competent authorities should always use information from a variety of sources when identifying risk factors. Paragraph 29 confirms that risk factors in respect of both, sectors/ sub-sectors and subjects or assessment should be identified.
- g) Guideline 4.2 paragraph 30 is based on paragraph 18 in the Original Guidelines. The draft guideline sets out a variety of sources that competent authorities should consider when gathering information for ML/TF risk factors identification purposes. Paragraph 18 has been revised by:
  - inserting referenced to the relevant legislation in order to avoid any confusion of the terms used in this paragraph, such as supranational risk assessment, national risk assessment and Opinion on the ML/TF;
  - moving the explanations of the type of information that should be collected to the relevant section in the draft guidelines, namely paragraphs 41, 44 and 45;
  - A paragraph stating “*Where relevant information is held by other competent authorities either at home or abroad, competent authorities should take steps to ensure that gateways make possible the exchange of that information, and that this information can be exchanged in a timely manner. This also applies to information held by the European Central Bank through the Single Supervisory Mechanism*” has been removed from the

guidelines as it is considered redundant in light of the enhanced cooperation requirements set out in paragraphs 20-23 of the revised guidelines;

- adding new sources of information, which, in some instances, have been created as a result of changing legal framework and might not have existed at the time of publication of the Original Guidelines or updated international guidance. The new sources include the EBA's risk assessment, AML/CFT colleges and colleges of prudential supervisors, tax authorities, prudential supervisors and AML/CFT supervisors in third countries.
- h) Guideline 4.2 paragraph 31 is based on paragraph 19 in the Original Guidelines. Paragraph 19 has been revised to include additional sources of information that may also be considered by competent authorities in order to identify and understand ML/TF risk factors. The new sources are the EBA's AML/CFT central database, whistleblowing reports and external auditors' reports. The reference to the 'Public information sources, such as newspaper reports' has been replaced with 'Publicly available information from reputable sources' in order to align the revised guidelines with the EBA's AML/CFT Risk Factors Guidelines<sup>5</sup>, which require that information is gathered from reputable sources.

#### Domestic risk factors

- i) Guideline 4.2 paragraph 32 is based on paragraph 20 in the Original Guidelines. Paragraph 20 has been revised to clarify that competent authorities should identify domestic ML/TF risks associated with subjects of assessment and also with sectors. Also, the revised guideline clarifies that ML/TF risks associated with all domestic activities of subjects of assessment or sectors should be considered to develop a holistic view of the domestic risks. This means that competent authorities should not be limited only to the assessment of risks associated with financial activities, because if subjects of assessment are also engaging in non-financial activities, like for example, trading in virtual currencies, it presents certain ML/TF risks that competent authority should be aware as it may have an impact on subjects of assessment and sectors risk profile. Therefore, a reference to the term 'financial' was removed.
- j) Guideline 4.2 paragraph 33 is based on paragraph 21 in the Original Guidelines. Paragraph 21 has been revised to emphasise the importance of developing a good understanding of, among other predicated offences, tax offences, domestically and abroad. To that end, a reference to 'tax offences' was included in points a) and b) in paragraph 33). In addition, a reference to 'private entities' in the last bullet point was replaced with a reference to 'relevant bodies' as the reliability of information supplied by a private entity may be called into question.

#### Foreign risk factors

- k) Guideline 4.2 paragraph 34 is based on paragraph 22 in the Original Guidelines. Paragraph 22 has been revised to highlight the need to identify foreign risk factors also in respect of sectors. In addition, the list of scenarios that may indicate significant links with other countries have been extended to include a reference to 'beneficial owners' in point a), and occasional transactions in point b). Also, the reference to 'high level of business relationships' in point a) has been replaced with a reference to 'significant level of business relationships'.
- l) Guideline 4.2 paragraph 35 is based on paragraph 23 in the Original Guidelines. Paragraph 23 has been revised to include a requirement that competent authorities should 'keep up to date'

<sup>5</sup> Consultation Paper on the draft guidelines under Articles 17 and 18(4) of Directive (EU) 2015/849 on customer due diligence and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions (JC 2019 87)

their knowledge of ML/TF risks associated with Member states and third countries. The guideline also includes a link with the EBA's Risk Factors Guidelines and clarifies that competent authorities should refer to paragraphs 32 and 33 in the revised guidelines, which refer to the identification of domestic risk factors, when identifying risk factors associated with specific Member States or third countries.

- m) Guideline 4.2 paragraph 36 is based on paragraph 24 in the Original Guidelines. Paragraph 24 has been revised to explain that the abbreviation MoneyVal stands for the 'European Council's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism'. No further changes were proposed in this guideline.

### Sector-wide ML/TF risk factors

- n) Guideline 4.2 paragraphs 37 - 39 are based on paragraphs 25 and 26 in the Original Guidelines. The revised guideline contains further explanations on what competent authorities should do to identify sector-wide risk factors. In particular:
- paragraph 25 has been revised to clarify how to determine sectors and sub-sectors. With a view to enhancing convergence in this area across the EU, the revised guidelines now include a list of different sectors that competent authorities should refer to when defining sectors which is aligned with categories of obliged entities listed in Directive (EU) 2015/849 and is also referred to in the EBA's Opinion on ML/TF risk.
  - Paragraph 25 has been revised to clarify that competent authorities should identify risks factors associated with sectors under their supervision. Therefore, a reference to 'each financial sector' has been deleted from the revised guidelines as it implies that competent authorities should assess risks in sectors which they do not supervise, which may not be the most effective use of their resources.
  - Guideline 4.2 paragraph 38 is a new guideline, which explains that in some instances it may be relevant to assess risks at a sub-sectoral level and the guideline explains what competent authorities should consider when defining sub-sectors.
  - Guideline 4.2 paragraph 39 is based on paragraph 26 in the Original Guidelines. The paragraph 26 has been revised to provide further clarification what information should be considered by competent authorities in order to identify risks within sectors and sub-sectors by making references to respective paragraphs within the revised guidelines.

### Type of information necessary to identify risk factors

- o) Guideline 4.2 paragraphs 40 – 42 are new guidelines. The guideline explains what type of information should be obtained by competent authorities in order to identify risk factors associated with sectors and sub-sectors. This guideline has been developed to mirror a similar section in the Original Guidelines that set out the type of information is necessary to identify risk factors associated with individual subjects of assessment.
- p) Guidelines 4.2 paragraphs 43 – 48 are based on paragraphs 27 to 29 in the Original Guidelines. The guideline explains what type of information should be obtained by competent authorities in order to identify risk factors and mitigating factors associated with the subject of assessment. It also makes a distinction and sets out what information should be used to inform that competent authorities understanding of the adequacy of mitigating measures and what information may indicate whether the mitigating measures have been implemented effectively as the necessary information may not be the same. The revised guideline contains further explanations in respect of:



- Guideline 4.2 paragraph 43 is based on paragraph 27 in the Original Guidelines. Paragraph 27 has been revised to specify that the starting point for competent authorities when trying to understand ML/TF risks associated with subjects of assessment is the sectoral or sub-sectoral risk assessment. In paragraph 27, the reference to ‘factors that mitigate inherent ML/TF risk’ has been replaced with the reference to ‘residual risk factors’ in line with the definitions. The revised guideline contains also cross-references to the relevant sources of information.
  - Guideline 4.2 paragraph 44 is based on paragraph 28 of the Original Guidelines. Paragraph 28 has been revised by replacing the term ‘significant shareholders’ with ‘qualifying shareholders’ in line with the EBA guidelines on qualifying holdings. In addition, a reference to beneficial owners has been incorporated in the point f) of the revised guidelines and the reference to ‘free provision of services’ has been replaced by a reference to ‘provision of services through non-face-to-face channels’ in point d) of the revised guidelines. In point e), the revised guidelines elaborate further on the type of information that competent authorities should seek to determine the ML/TF risks associated with the subjects of assessment customers. Also, in point a) the reference to ‘international’ has been removed from the revised guidelines as it was deemed redundant as the guideline already contains a reference to ‘foreign’, which has the same meaning as international.
- q) Guideline 4.2 paragraph 45 is based partly on paragraph 28 in the Original Guidelines. Paragraph 28 has been split between paragraph 44 and 45 to distinguish between the type of information that should be obtained to identify inherent risk factors, and the type of information that may indicate whether:
- subjects of assessment have put in place adequate AML/CFT systems and controls, which is set out in point a) of the revised guideline, where, in addition to the types of information listed in point iv) that were provided in the Original Guidelines, the revised guidelines list other types of information in points i) to iii); and
  - these systems and controls are implemented effectively, which is set out in point b) of the revised guideline 4.2 paragraph 45, where, in addition to the types of information listed in points i) and ii) that were provided in the Original Guidelines, the revised guidelines also list other types of information that should be considered in points iii) to v).
- r) Guideline 4.2 paragraph 46 is based on paragraph 29 in the Original Guidelines. Paragraph 29 has been revised to broaden the sources where the necessary information should be obtained by specifically referring to paragraphs 30 and 31 in the revised guidelines, instead of limiting the sources only to ‘prudential and/or conduct supervision’. The revised guideline also explains that where the information is not available through the sources listed in paragraphs 30 and 31, competent authorities should consider to obtain this information from subjects of assessment. Therefore the provisions in paragraph 29 which stated ‘This information may originate from the overall prudential and/or conduct supervision and take into account, where relevant, prudential information obtained in the context of the Single Supervisory Mechanism’. However, it may be appropriate to collect such information specifically if it is not already held on the competent authorities’ records’ have been replaced with provisions in the revised guideline 4.2 paragraph 46.
- s) Guideline 4.2 paragraphs 47 and 48 are new guidelines, which have been introduced in light of concerns raised by the EBA Report, which was published in February 2020. In this report, the EBA identified that ‘most competent authorities used questionnaires at different intervals to obtain data from banks to inform their ML/TF risk assessment of each bank’. In some cases,

supervisors asked for similar data but in a different formats and, in some instances, it transpired that only part of the information requested from banks was in fact used by competent authorities. This meant that in some instances banks were overburdened with data requests from supervisors. To address this, the guideline 4.2 paragraph 48 sets out various factors that should be considered by competent authorities when requesting information from subjects of assessment for the purposes of the competent authority's risk assessment.

**Question 3: Do you have any comments on the proposed changes to the Guideline 4.2 'Step 1- Identification of risk and mitigating factors'? Please note that only comments in respect of the changes can be considered.**

#### 4.2.4 Amendments to Guideline 4.3: Step 2 – Risk assessment

22. In line with Article 48(6) of Directive (EU) 2015/849, competent authorities are obliged to have a clear understanding of the ML/TF risk present in their Member States. Competent authorities' risk assessment then forms basis for competent authorities' risk based approach.

23. It is evident that competent authorities are at different maturity levels in terms of their risk assessments and, while most competent authorities assessed by the EBA as part of its implementation reviews, were striving to implement a robust risk assessment process, many found it challenging to incorporate the risk factors identified by them in their supervisory risk assessments.

24. To that end, the revised guidelines set out the main components of a risk assessment. For clarity purposes and in order to emphasise the importance of the sectoral risk assessment, the revised guidelines make a clear distinction between individual risk assessments of subjects of assessment and sectoral/ sub-sectoral risk assessments. The guidelines also introduce a requirement for competent authorities to develop a good understanding of ML/TF risks associated with the group.

25. In terms of substance, the EBA has proposed to amend Guideline 4.3 as follows:

##### General considerations

- a) Guideline 4.3 paragraph 49 is based on paragraph 31 in the Original Guidelines. Paragraph 31 has been revised to include a reference to the 'sectoral risk assessments'.
- b) Guideline 4.3 paragraph 50 is a new guideline. The guideline explains the relationship between sectoral and individual risk assessments and requires competent authorities to use sectoral risk assessments as a basis for their individual risk assessments and to use individual risk assessments collectively to develop their understanding of risks within the sector.

##### Sectoral risk assessments

- c) Guideline 4.3 paragraphs 51 - 55 are new guidelines. The guideline has been introduced to address concerns raised in the EBA Report, which found that the majority of competent authorities that were assessed as part of the implementation reviews had not carried out an assessment of ML/TF risks associated with their banking sector, or had not done so comprehensively. The report highlights that the lack of comprehensive ML/TF risk assessment of sectors and, in some cases, sub-sectors, may have far-reaching consequences. In particular, the lack of sectoral risk assessment contributed to divergent views between competent authorities and representatives from the sector in respect of the ML/TF risks affecting the

banking sector, and of the ML/TF risks specific to different types of banks or sub-sectors, which have impacted on the competent authorities' ability to challenge banks constructively on their risk assessments.

- d) To that end, the guidelines set out a clear obligation on competent authorities to develop a good understanding of ML/TF risks and explain how to carry out the sectoral risk assessment.
- e) The guideline also explains that where competent authorities decide to incorporate residual risk in their sectoral risk assessment, they should consider whether they have sufficient information to carry out such an assessment. Where competent authorities have only limited information on the mitigating measures within the sector, they should consider whether it is more adequate to rely on the inherent risk assessment, at least for as long as they develop better understanding, through their supervisory activities like on-site inspections, of the level and quality of systems and controls implemented by subjects of assessment within the sector.

### Individual risk assessments

- f) Guideline 4.3 paragraphs 56 - 59 are broadly based on paragraph 32 of the Original Guidelines. While the requirement to assess risks associated with subjects of assessment is not new, the EBA's Report highlighted certain challenges experienced by competent authorities when it comes to implementing the risk assessment methodology in practice. In particular, the report highlights challenges relating to the number and type of risk factors used to determine a risk rating. The report highlights also concerns about the assessment of residual risk by competent authorities, which was often based on information collected from subjects of assessment as part of the self-assessment questionnaire. Therefore, the guidelines have been revised to address these challenges, in particular:
  - paragraph 32 in the Original Guidelines has been split between guideline 4.3 paragraph 60, in respect of inherent risk; and guideline 4.3 paragraph 58 in respect of residual risk. This was deemed necessary to make it more clear that the assessment of these risks may require the identification of different risk factors and different type of information.
  - The revised guideline 4.3 paragraph 57 explains that, when carrying out the risk assessment of subjects of assessment, competent authorities should follow a determined process and methodology. Although the finding from the EBA Report show that this is already done by the majority of competent authorities, the revised guidelines aim to highlight the need for a continuous review of this process.
  - The revised guideline 4.3 paragraph 58 makes it clear that a meaningful assessment of residual risk may not be always possible in circumstances where competent authorities have insufficient or incomplete information on mitigating measures put in place by subjects of assessment. The EBA Report raises concerns about a current practice whereby competent authorities rely largely on the self-assessment of subjects of assessment for their residual risk assessment, which may distort the competent authorities' understanding of the final risk score as, in some instances, it may be unable to establish whether a bank's ML/TF risk rating resulted from, for example, a high level of inherent ML/TF risk and effective AML/CFT controls, or a moderate level of ML/TF risk and ineffective AML/
  - Guideline 4.3 paragraph 56 is a new guideline, which requires competent authorities to develop a comprehensive understanding of inherent and residual risks, where it is possible.

### Assessment of ML/TF risks at a group level

- g) Guideline 4.3 paragraphs 60 - 62 are new guidelines. In line with the current legal framework, competent authorities are required to assess ML/TF risks associated with subjects of assessment under their supervision. This includes risks arising from subjects' of assessment operations in other countries through their branches and subsidiaries. In addition, Directive (EU) 2015/849 requires that competent authorities ensure that group-wide policies and procedures are applied effectively in the subjects' of assessment branches and subsidiaries. However, the post-mortem report on European banks by the European Commission, identified that cooperation was often limited or insufficient.

Since the publication of the Original Guidelines, Directive (EU) 2018/843 has clarified the legal basis for the supervisory cooperation nationally and on a cross-border basis.

To that end, the revised guidelines require that the competent authority, which is the lead supervisor, develops a good understanding of ML/TF risks associated with subjects of assessment that are part of a group and explains what competent authorities should do to understand the risks at a group level.

### Weighting of risk factors

- h) Guideline 4.3 paragraphs 63 and 64 are based on paragraphs 33 to 36 in the section titled 'Weighting inherent risk factors and mitigating factors' in the Original Guidelines. When competent authorities weigh risk factors, they should do so based on a good understanding why they use certain risk factors to assess ML/TF risk associated with sectors or subjects of assessment and should ensure that weighting of these risk factors is well founded and understood. To that end, the amendments to the guidelines are:
- Paragraph 33 of the Original Guidelines, which is paragraph 63 in the revised guidelines, impose an obligation on competent authorities to weight risk factors in respect of sectors and subjects of assessment;
  - Paragraph 34 of the Original Guidelines has been split between paragraph 63 a) in the revised guidelines, which has been revised by removing a reference to 'mitigating factors' and include references to 'sectoral and sub-sectoral risk factors'; and paragraph 63 b) in the revised guidelines, which now contains a reference to 'sectors and sub-sectors.
  - Paragraph 35 of the Original Guidelines, which is a paragraph 63 d) in the revised guidelines, has been revised to include an additional explanation '*When weighting risk factors, competent authorities should ensure to avoid that one risk factor does not sway the balance of the overall weighting to a disproportionate and unreasonable assessment.*'
  - Paragraph 36 of the Original Guidelines has been removed from the revised guidelines as the adequate weighting of mitigating factors may not be possible in all cases and may distort the overall risk score of subjects of assessment or sectors.
  - Guidelines 4.3 paragraph 63 c) and paragraph 64 are new guidelines.

### Risk profiles and categories

- i) Guideline 4.3 paragraphs 65 and 69 are based on paragraphs 37 to 40 of the Original Guidelines. The EBA has observed a significant divergence across the EU in terms of the risk categorisation and, with the proposed amendments to the guidelines, has tried to foster the convergence in this area. To that end, the amendments to the guidelines are:
- Paragraph 37 of the Original Guidelines is split between paragraph 65 and 68 in the revised guidelines. There have been only minor drafting changes made in this paragraph.
  - Paragraph 38 of the Original Guidelines is now paragraph 69 in the revised guidelines. Paragraph 38 has been revised to achieve greater convergence and the guideline now requires competent authorities to consider the use of the risk categories set out in the revised guidelines, whereas the original guidelines contained only an indication of the risk categories that were adopted by competent authorities. The prescribed risk categories – less significant risk, moderately significant risk, significant risk and very significant risk – is consistent with other risk-related legal instruments issued by the EBA, like the Opinion on ML/TF risk which is published by the EBA every two years under Article 6(5) of Directive (EU) 2015/849. By adopting the proposed risk categories, competent authorities would support the identification and assessment of EU-wide risks and ensure a common understanding of risks, which would be important for cross-border supervision, for example.
  - Paragraph 39 of the Original Guidelines has been removed from the revised guidelines.
  - Paragraph 40 of the Original Guidelines is now paragraph 73 and no changes are being proposed in this guideline.
  - Guideline 4.3 paragraphs 66, 67, 70, 71, 72 and 74 are new guidelines.

**Question 4: Do you have any comments on the proposed changes to the Guideline 4.3 ‘Step 2 – Risk assessment’? Please note that only comments in respect of the changes can be considered.**

#### 4.2.5 Amendments to Guideline 4.4: Step 3 – Supervision

26. In line with the FATF guidance, a risk-based approach to supervision involves tailoring the supervisory actions and response to address the specific risks within the sector or subjects’ of assessment. This approach allows supervisors to allocate resources effectively and focus on higher risk areas.

27. The EBA report highlights that competent authorities were finding it challenging to translate the theoretical knowledge of ML/TF risks into supervisory practice and risk-based supervisory strategies. The report also refers to competent authorities’ failures to assess the effectiveness of AML/CFT systems and controls put in place by financial institutions, rather than merely test the institution’s compliance with a prescriptive set of AML/CFT requirements.

28. To that end, the guidelines have been revised to address weakness identified by FATF and the EBA related to the risk based supervision in the EU.

29. In terms of substance, the EBA propose to amend Guideline 4.4 as follows:

##### General provisions

- a) Guideline 4.4 paragraph 75 is based on paragraph 43 of the Original Guidelines. Paragraph 43 has been revised by removing all references to ‘examples’ and by replacing references to

'high/higher ML/TF risks' with 'significant/ more significant ML/TF risks'. In particular, the guidelines have been revised:

- by removing an example that stated that "Competent authorities should note that off-site supervision alone is unlikely to be sufficient in higher risk situations" from point a);
- by inserting a reference to "the overall AML/CFT framework in place at subjects' of assessment" in point b);
- by inserting a clarification "by ensuring that subjects of assessment that are exposed to more significant ML/TF risks are supervised more frequently than those subjects of assessment that are exposed to less significant risks" and by removing a reference to the "monitoring of key indicators less often where the risks are reduced".
- by inserting a reference "where the exposure to ML/TF risks is more significant" as the end of the paragraph.

### Supervisory strategy

- b) In line with the international standards set by FATF, competent authorities should put in place a clear AML/CFT supervisory strategy, which is linked with their risk assessment. The EBA report identified that in many cases, there was no clear link between the risk assessment and the strategy put in place by competent authorities, which had a negative impact on competent authorities' ability to develop a comprehensive supervisory strategy that focuses on the areas of greatest risk. The following changes were made to Guideline 4.4:
- Guideline 4.4 paragraph 76 is a new guideline. The guideline emphasises the need for the strategy to be long-term and that it should be developed specifically for the purposes of AML/CFT supervision, instead of, for example, being an addition to the prudential strategy.
  - Guideline 4.4 paragraph 77 is based broadly on paragraph 41 of the Original Guidelines. Paragraph 41 has been revised to remove the requirement that the strategy should be developed for each subject of assessment. Instead the revised guideline in paragraph 77 focuses on the need to develop supervisory strategy for sectors and sub-sectors which is based on the sector-wide risk assessment.
  - Guideline 4.4 paragraph 78 is a new guideline, apart from point e), which is based on paragraph 49 of the Original Guidelines. Paragraph 49 however has been revised to remove a reference to 'all obliged entities', which is in line with international guidance developed by FATF, which requires for the strategy to be implemented at a sector level and not at the level of individual institutions.

### AML/CFT supervisory plan

- c) Guideline 4.4 paragraph 79 is a new guideline but it contains certain elements from paragraph 49 of the Original Guideline. The key aim of the revised guideline is to emphasise the need for the supervisory plan to be linked to the supervisory strategy. In the absence of a clear link between the strategy and the plan, it is arguable that competent authorities would be able to implement an effective RBS model, as their supervisory actions are generally determined by emerging risk or the risk that has already crystallised. This means that competent authorities' approach become more reactive than proactively finding weaknesses in the subjects' of assessment AML/CFT frameworks with an aim to mitigate them before the risk has crystallised. In addition, the paragraph 82 contains the requirement for competent authorities to 'coordinate their individual supervisory plans', which has been moved over from paragraph 49 of the Original Guidelines.

- d) Guideline 4.4 paragraph 80 is a new guideline, which explains the key elements that should be included in the supervisory plan.
- e) Guideline 4.4 paragraph 81 is based on paragraph 42 of the Original Guidelines. Paragraph 42 has been revised to include a specific reference to the supervisory plan.
- f) Guideline 4.4 paragraph 82 is based on paragraph 45 of the Original Guidelines. Paragraph 45 has been revised by:
- replacing references to ‘firms’ with references to ‘subjects of assessment’;
  - inserting a reference to ‘their ML/TF risk assessment’;
  - replacing a reference to ‘high levels of ML/TF risk’ with a reference to ‘significant or very significant levels of ML/TF risk’
  - inserting a caveat ‘where available’ to clarifying that prudential or conduct risk assessment may not be always available to all AML/CFT supervisors in all sectors.
- g) Guideline 4.4 paragraph 83 is a new guideline.
- h) Guideline 4.4 paragraph 84 is based on paragraph 46 of the Original Guidelines. Paragraph 46 has been revised by:
- including an obligation on competent authorities to include in their plans considerations of potential emerging risks and how they will be addressed. In the absence of such planning, the EBA has observed that competent authorities fail to fulfil their supervisory plans as they are continuously required to divert their attention and resources to address emerging or crystallised risks. Better planning would ensure that sufficient resources are allocated to take on additional reviews and inspections on an ad hoc basis, if necessary, without jeopardising the fulfilment of the entire supervisory plan.
  - explaining what needs to be documented by competent authorities when making changes to the supervisory plan, by inserting a reference “explaining how and when the supervision of those subjects of assessment affected by the changes to the plan will be carried out”;
  - inserting a reference “in order to adapt to the new circumstances”;
  - explaining the type of changes that may take place by inserting a sentence “This may include a change from off-site review to an on-site inspection or a change from a thematic review to a full scope inspection.”
- i) Paragraph 47 of the Original Guidelines has been removed from the guidelines avoid duplication.

### Supervisory tools

- j) Guideline 4.4 paragraphs 85 - 97 are new guidelines. In order to carry out the AML/CFT supervision effectively, competent authorities are required to adjust the frequency, intensity and intrusiveness of AML/CFT supervision on a risk-sensitive basis. To achieve this, competent authorities should identify the most adequate supervisory tools that would allow them to address ML/TF risks within a sector or a subject of assessment in the most effective way. Competent authorities should recognise that, while full scope on-site inspection is a tool that provides a comprehensive view of the subject of assessment’s overall AML/CFT compliance framework, it is also an extremely resource intensive process. Therefore, it might be more effective to reserve the use of this tool to those subjects of assessment that are exposed to significant or very significant risks.
- k) The EBA report found that, although competent authorities have a variety of supervisory tools available to them, they often fail to use these tools effectively or strategically and, in most cases, resort to carrying out full-scope onsite inspections. This meant that most competent

authorities were unable to make the best use of often limited supervisory resources and that, in many cases, the population of actively supervised banks was very small.

- l) Through the implementation reviews, the EBA has observed that there is a lack of common understanding of what can be achieved through different tools to meet the supervisory objectives and how different tools should be applied. Therefore, the guidelines aim to achieve convergence in this area by defining different tools and explaining how they should be applied in different circumstances in respect of individual subjects of assessment and also those, which form part of the group.

#### Supervisory practices and the supervisory manual

- m) Guideline 4.4 paragraphs 98 - 103 are new guidelines. The EBA report recognised that most competent authorities used supervisory manuals to ensure consistent application of their risk-based approach within competent authorities. However, the report also highlighted that in some cases, the level of detail contained in these manuals made it difficult for supervisors to adjust their approach in line with the ML/TF risks they had identified during inspections, and inspection reports suggested that there was a risk that systemic AML/CFT compliance failures were being missed or not being recorded.
- n) To that end, EBA has set out in the revised guidelines the main processes that should be covered in the supervisory manual. In particular the guidelines explain how competent authorities should test the effectiveness of subjects' of assessment AML/CFT framework and set out factors that should be considered in order to implement a robust sampling policy.

#### Quality assurance

- o) Guideline 4.4 paragraphs 104 -107 are new guidelines. Constant rotation of staff that many competent authorities are exposed to, leave them vulnerable to knowledge gaps and information void. With this in mind, competent authorities should be mindful and consider how they can ensure that the supervisory approach is followed consistently by all their supervisors and that adequate supervisory standards are maintained, regardless of staff changes. To address this, the guidelines set out a number of ways how competent authorities can ensure consistency and quality of their supervisory approach.
- p) In addition, the EBA report highlights an increasing reliance by competent authorities when carrying out their risk assessment on data and information provided by subjects of assessment, without checking the reliability and accuracy of this information. Therefore, the revised guidelines require that competent authorities implement sufficient quality controls checks to identify any inconsistencies.

#### External parties

- q) Guideline 4.4 paragraphs 108 - 113 are new guidelines. The EBA is aware that in some instances, many competent authorities may engage external parties, like consultants or auditors, to carry out certain supervisory activities. This approach is adopted to address the resource shortages or skills gap, where, for example, a competent authority may require an assistance with the assessment of a specialised IT systems and controls.
- r) However, the engagement of external parties exposes competent authorities to certain risks. Therefore, these guidelines outline a number of these risks and explain the safeguards that should be put in place by competent authorities to mitigate these risks.



### Supervisory follow up

- s) Guideline 4.4 paragraphs 114-121 are new guidelines. The EBA report highlights weaknesses in competent authorities' approaches to supervisory follow up in situations where previously breaches and weaknesses in the subject of assessment's AML/CFT controls framework had been identified. The report determines that many competent authorities afforded little priority to following up on banks' remedial actions, regardless of the nature and type of the breach that had been identified. As a result, the effectiveness of competent authorities' remedial efforts has been called into question.
- t) The guidelines recognise that not all breaches or weaknesses will require the same type and extent of supervisory follow up as it will often be determined by the nature and type of breaches or weaknesses identified. However, the guidelines are clear that the reliance solely on the subject's of assessment proposed remediation plan is not an adequate follow up in all cases. While the guidelines recognise the importance of the supervisory judgment when it comes to determining supervisory follow up, they also require that, for consistency purposes, competent authorities formalise their supervisory follow up process and set it out in their manual.

### Feedback to the sector

- u) Guideline 4.4 paragraphs 122 - 132 are new guidelines. The guidelines recognise that communication with the sector, if used strategically, can be a very useful supervisory tool. From the EBA report, it is evident that competent authorities have wide variety of communication tools at their disposal and use them, though few do so strategically. The EBA found that this meant that communication was not always effective. Therefore, in line with the EBA report, the guidelines require competent authorities to consider how best to communicate with the sector and to develop a communication strategy, which sets out how competent authorities will communicate with the sector, and which tools they will use to achieve their objectives. In addition, the guidelines make a distinction between the communication of the outcomes from the risk assessment and the combination of guidance.
- v) In the Original Guideline, the communication with the sector was considered as part of Step 4 of the RBS model. Since engagement with the sector is an important part of the on-going supervision, this section has been moved the section to Step 3. In terms of substance, Guideline 4.4 has been revised as follows:
  - Guideline 4.4 paragraphs 122 – 128 are new guidelines.
  - General approach to communication with the sector set out in Guideline 4.4 paragraphs 129 - 132 are broadly based on paragraph 71 and 72 in the Original Guideline. However, the text of paragraph 71 has been replaced by new provisions set out in paragraphs 129, 130 and 132 and examples provided in paragraph 72 have been incorporated in paragraph 131.

### De-risking

- w) De-risking is a practice whereby credit or financial institutions may refuse to enter into or decide to terminate, business relationships with some customers that they associate with significant ML/TF risk. De-risking strategies are often applied to entire categories of customers, irrespective of the ML/TF risk associated with individual business relationships or occasional

transactions. This means that customers in these categories may be prevented from accessing financial services.

- x) The EBA has also highlighted de-risking as one of risks affecting the EU financial sector in the Joint Opinions on risks published in 2017, 2019 and 2021.
- y) To that end, the revised guidelines in paragraph 125 suggest that competent authorities should be mindful of various indicators that may suggest the need for further guidance within the sector and, among other indicators, also lists an ‘evidence of de-risking’. In addition, the revised guidelines in paragraph 126 require that competent authorities should consider whether their guidance could have unintended consequences such as wholesale de-risking of entire categories of customers, and mitigate any adverse effects their guidance may have on certain sectors or subjects of assessment.

### Training

- z) The EBA report points at a worrying trend within the EU whereby competent authorities are finding it challenging to recruit sufficiently skilled AML/CFT supervisory staff. This means that sufficient emphasis should be put on staff training within competent authorities as the lack of sufficient and adequate training may have negative impact on competent authorities’ approach to supervision. Therefore, competent authorities should first determine their staff training needs and then decide how best to address these needs. In terms of substance, Guideline 4.4 has been revised as follows:
  - Guideline 4.4 paragraphs 133, 134 and 136 are new guidelines.
  - Guideline 4.4 paragraph 135 incorporates certain aspects of paragraphs 69 and 70 of the Original Guidelines. The reference linking both guidelines is as follows:” the outcomes of the sector-wide and individual ML/TF risk assessments are communicated to all relevant staff within the competent authority, including staff who are not directly involved in the risk-based AML/CFT supervision”, although the original text has been fully replaced.

**Question 5: Do you have any comments with the proposed changes to the Guideline 4.4? Please note that only comments in respect of the changes can be considered.**

#### 4.2.6 Amendments to Guideline 4.5: Step 4 – Monitoring and updating of the RBS model

30. The guidelines set out that in the final step of the RBS model, competent authorities are required to review their approach, including their risks assessments and their methodology, and their supervisory strategy and plans. As a result, if inconsistencies or weaknesses are identified, the guidelines require competent authorities to make adjustments where necessary.

31. In terms of substance, the EBA has proposed to amend Guideline 4.5 as follows:

#### Review of the risk assessment and supervisory strategy and plans (Steps 1, 2, and 3)

- a) Guideline 4.5 paragraph 138 is based on paragraph 54 of the Original Guidelines. Paragraph 54 has been revised by adding a reference to ‘competent authorities should carry out periodic or ad hoc reviews’, imposing a clear obligation on competent authorities.
- b) Guidelines 4.5 paragraph 139 and 140 are new guidelines.

- c) Guideline 4.5 paragraph 141 is based on paragraph 55 in the Original Guidelines. Paragraph 55 has been revised to confirm the requirement that competent authorities should verify the outcomes of their sectoral and individual risk assessments by inserting the following text: “As part of this, it is important that competent authorities verify that the underlying assumptions supporting the risk assessment are still up to date, including assumption related to the different level of risks posed by the relevant sectors and subjects of assessment or the understanding of the effectiveness associated with a certain supervisory tool.”
- d) Guideline 4.5 paragraph 142 is based on paragraph 56 in the Original Guidelines. Paragraph 56 has been revised by requiring that the schedule of each review should be ‘aligned with the supervisory strategy’.
- e) Guideline 4.5 paragraph 143 is based on paragraph 57 in the Original Guidelines. Paragraph 57 has been revised by inserting a reference to the ‘strategy’ in the introductory section of the paragraph and by inserting points d) – g).
- f) Guideline 4.5 paragraph 145 is based on paragraph 58 in the Original Guidelines. Paragraph 58 has been revised by inserting a text at the end of the paragraph ‘which are significantly affected by the change’.
- g) Guideline 4.5 paragraph 146 is a new guideline.

#### Review of the AML/CFT RBS model

- h) Guideline 4.5 paragraph 147 is based on paragraph 59 of the Original Guidelines. Paragraph 59 has been revised by inserting a reference to ‘processes’ and ‘up to date’ and by including a new requirement that “Competent authorities should review and update the methodology immediately, where necessary.”
- i) Guideline 4.5 paragraph 148 is based on paragraph 60 of the Original Guidelines. Paragraph 60 has been revised by replacing the term ‘not be changed’ with ‘refrain from making’ and by inserting a reference to ‘changes to their RBS model’.
- j) Guideline 4.5 paragraph 148 is a new guideline.
- k) Guideline 4.5 paragraph 149 are based on paragraphs 61 and 62 of the Original Guidelines. Paragraph 61 has not been revised, however paragraph 62 now contains an obligation that competent authorities “should use a variety of tools available to them when reviewing and assessing the adequacy and effectiveness of their AML/CFT RBS model”. Also, point c) has been revised by inserting the term ‘measures’, point d) has been revised by inserting a term ‘authorities’, point e) has been revised by inserting a reference to ‘feedback from Financial Intelligence Units’ and point f) has been revised by inserting a reference to ‘publications’.
- l) Guideline 4.5 paragraph 150 is based on paragraph 62 of the Original Guidelines. Paragraph 62 has been revised by inserting a reference to ‘when possible’ at the end of the paragraph.
- m) Guideline 4.5 paragraph 151 is based on paragraph 63 of the Original Guidelines. Paragraph 63 has not been revised.
- n) Guideline 4.5 paragraph 152 is based on paragraph 64 of the Original Guidelines. Paragraph 64 has been revised by removing the third bullet point from the guideline, which stated “Significant changes to the supervisory system such as the creation of a new division or large increases in staff, change of board members or the management, or significant changes in the financial sector” and by inserting point d).

#### Organisational and procedural aspects of the review process

- o) Guideline 4.5 paragraph 153 is based on paragraph 65 of the Original Guidelines. Paragraph 65 has been revised to clarify that the responsibility to 'put in place an objective review process of their RBS model' lies with competent authorities. In addition, paragraph 65 has been revised by inserting a reference to 'or what events would trigger the review' in point a), by inserting a new point b) and by including minor drafting changes in point c).
- p) Guideline 4.5 paragraph 154 is based on paragraph 66 of the Original Guidelines. Paragraph 66 has been revised by replacing 'may' with 'should' and by inserting the text 'whether it is necessary to engage'.

#### Record keeping

- q) Guideline 4.5 paragraph 155 is based on paragraphs 67 of the Original Guidelines and no changes have been made to this paragraph.

#### Accountability

- r) Guideline 4.5 paragraph 156 is based on paragraphs 68 of the Original Guidelines and no changes have been made to this paragraph.
- s) Guideline 4.5 paragraph 157 is a new guideline.

#### Form of feedback

- t) Paragraphs 69 to 72 in the Original Guidelines were moved to Guideline 4.5 in the revised guidelines and incorporated in various paragraphs between 122 and 132, see the relevant guideline.

**Question 6: Do you have any comments on the proposed changes to the Guideline 4.5? Please note that only comments in respect of the changes can be considered.**



## 4. Draft Guidelines

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EBA/GL-REC/20XX/XX

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## Draft Guidelines

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On the characteristics of a risk-based approach to anti-money laundering and terrorist financing supervision, and the steps to be taken when conducting supervision on a risk-sensitive basis under Article 48(10) of Directive (EU) 2015/849 (amending the Joint Guidelines ESAs 2016 72)

### **The Risk-Based Supervision Guidelines**

# 1. Compliance and reporting obligations

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## Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010<sup>6</sup>. In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities and financial institutions must make every effort to comply with the guidelines.
2. Guidelines set the EBA view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. Competent authorities as defined in Article 4(2) of Regulation (EU) No 1093/2010 to whom guidelines apply should comply by incorporating them into their practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

## Reporting requirements

3. According to Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must notify the EBA as to whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by ([dd.mm.yyyy]). In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form available on the EBA website with the reference 'EBA/GL/201x/xx'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities. Any change in the status of compliance must also be reported to EBA.
4. Notifications will be published on the EBA website, in line with Article 16(3).

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<sup>6</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, (OJ L 331, 15.12.2010, p.12).

## 2. Subject matter, scope and definitions

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### Subject matter

5. These guidelines specify according to Article 48(10) of Directive (EU) 2015/849<sup>7</sup> the characteristics of a risk-based approach to anti-money laundering and countering the financing of terrorism (AML/CFT) supervision and the steps competent authorities should take when conducting supervision on a risk-sensitive basis.

### Scope of application

6. Competent authorities should apply these guidelines when designing, implementing, revising and enhancing their own AML/CFT risk-based supervision model (RBS model).

### Addressees

7. These guidelines are addressed to competent authorities as defined in point (2)(iii) of Article 4 of Regulation (EU) No 1093/2010.

### Definitions

8. Unless otherwise specified, terms used and defined in Directive (EU) 2015/849 have the same meaning in the guidelines. In addition, for the purposes of these guidelines, the following definitions apply:

<b>Ad hoc inspection</b>	means a review, that is triggered by a specific event or ML/TF risk
<b>AML/CFT returns</b>	means regular or ad hoc requests by competent authorities to subjects of assessment for quantitative or/and qualitative data and information relating to key ML/TF risk indicators.
<b>Cluster</b>	Means two or more credit institutions or financial institutions in a sector having similar characteristics and exposure to the same levels of ML/TF risk.
<b>De-risking</b>	means a refusal to enter into, or a decision to terminate, business relationships with some categories of customers associated with

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<sup>7</sup> Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (OJ L 141, 5.6.2015, p.73).



more significant ML/TF risk irrespective of the ML/TF risk associated with individual business relationships or occasional transactions.

**Emerging risk**

means a risk that has never been identified before or an existing risk that has significantly increased.

**Follow up inspection**

means a review, which serves to assess whether weaknesses in subject of assessment's AML/CFT systems and controls framework identified during a previous inspection or review have been corrected.

**Full-scope on-site inspection**

means a comprehensive review of all AML/CFT systems and controls implemented by subjects of assessment or their business lines, which takes place on the premises of subject of assessment.

**Inherent risk**

refers to the level of ML/TF risk present in a subject of assessment or a sector before mitigating measures are applied

**ML/TF Risk**

Means the likelihood and impact of ML/TF taking place.

**ML/TF risk factors**

Means variables that, either on their own or in combination, may increase or decrease ML/TF risk.

**Off-site review**

means a comprehensive review of subject' of assessment AML/CFT policies and procedures, which is not taking place on the premises of subjects of assessment.

**Risk-based approach (RBA)**

Means an approach whereby competent authorities and subjects of assessment identify, assess and understand the ML/TF risks to which subjects of assessment are exposed and take AML/CFT measures that are proportionate to those risks.



<b>RBS Model</b>	Refers to the whole set of procedures, processes and mechanisms that competent authorities use to exercise their AML/CFT supervisory powers in a way that is commensurate with the identified ML/TF risks.
<b>Residual risk</b>	means the level of risk that remains after AML/CFT systems and controls are applied to address the inherent risk.
<b>Risk profile</b>	refers to the overall characteristics of the ML/TF risk associated with the subject of assessment or sector/sub-sector, including the type and level of risk.
<b>Subject of assessment</b>	Means a credit institution or a financial institution or a cluster, categorised according to criteria laid down by the competent authorities.
<b>Supervisory tools</b>	means all supervisory measures competent authorities can take to ensure compliance by subjects of assessment with their AML/CFT obligations.
<b>Thematic inspection</b>	means a review of a number of subjects of assessments that focus on one specific or very few aspects of these subject of assessments' AML/CFT systems and controls.
<b>Threat</b>	Means the potential harm caused by criminals, terrorists or terrorist groups and their facilitators, through their past, present and future ML or TF activities.



## 3. Implementation

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### Date of application

9. These Guidelines will apply three months after publication in all EU official languages.

### Repeal

10. The following guidelines are repealed with effect from the date of application.

Joint Guidelines on the characteristics of a risk-based approach to anti-money laundering and terrorist financing supervision, and the steps to be taken when conducting supervision on a risk-sensitive basis (ESAs 2016 72)

## 4. Guidelines

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### 4.1 Implementing the RBS model

#### 4.1.1 General considerations

11. Competent authorities should apply the following four steps as part of an effective AML/CFT RBS model:
  - a) Step 1 – Identification of ML/TF risk factors;
  - b) Step 2 – Risk assessment;
  - c) Step 3 – Supervision; and
  - d) Step 4 – Monitoring and review of the RBS model.
12. Competent authorities should note that the risk-based supervision is not a one-off exercise, but an ongoing and cyclical process.
13. Competent authorities should implement the general considerations set out in paragraphs 11 and 12 of these guidelines throughout their RBS model.

#### 4.1.2 Proportionality

14. Competent authorities should be proportionate in their supervision of subjects of assessment for AML/CFT purposes. The extent of information sought, and the frequency and intensity of supervisory engagement and dialogue with a subject of assessment should be commensurate with the ML/TF risk identified.
15. Competent authorities should recognise that the size or systemic importance of a subject of assessment may not, by itself, be indicative of the extent to which it is exposed to ML/TF risk; small credit institutions or financial institutions that are not systemically important can nevertheless pose a high ML/TF risk.

#### 4.1.3 Subjects of assessment

16. Competent authorities should identify those credit institutions or financial institutions within each sector that share a sufficient amount of similar characteristics in order to be grouped in one cluster. The shared characteristics should include the same level of risk that they are exposed to, inter alia, their size, the nature of their business, the type of customers serviced, the geographic area they operate in or activity and their delivery channels. For clustered credit



institutions or financial institutions, the RBS process may be carried out at the collective level of the cluster itself, rather than at the level of each individual credit institution or financial institution within that cluster.

17. In order to identify those credit institutions or financial institutions that may belong to the same cluster, competent authorities should refer to their business model, the sectoral risk assessment, the risk assessments of individual credit institutions or financial institutions as well as other relevant sources of information as set out in paragraphs 30 and 31 of these guidelines, including the information gathered as a result of their supervisory activities.
18. Competent authorities should consider whether they will treat credit institutions or financial institutions in the same sector that form part of the same domestic financial group as one 'subject of assessment', but should not cluster them.
19. Should a competent authority know, or have reasonable grounds to suspect, that the risk associated with an individual credit institution or financial institution in a cluster varies significantly from that associated with other credit institutions or financial institutions in that cluster, the competent authority should remove that credit institution or financial institution from the cluster and assess it either individually, or as part of a different cluster of credit institutions or financial institutions, which are exposed to a similar level of ML/TF risk. This may happen in circumstances where the credit institution or financial institution is beneficially owned by individuals whose integrity is in doubt due to ML/TF concerns, or because the credit institution's or financial institution's internal control framework is deficient, which has an impact on the credit institution's or financial institution's residual risk rating, or because the credit institution or financial institution has changed significantly its products or services.

#### **4.1.4 Cooperation**

20. Competent authorities should cooperate and exchange all relevant information with each other and with other stakeholders, including prudential supervisors, Financial Intelligence Units, tax authorities, law enforcement agencies and AML/CFT supervisors of third countries to ensure the effective AML/CFT supervision of subjects of assessment. All relevant information should be exchanged without delay. Where subjects of assessment operate on a cross-border basis, such cooperation should extend to competent authorities of other Member States and where relevant, competent authorities of third countries.
21. In order to cooperate and exchange information effectively, competent authorities should apply all cooperation and coordination measures and tools at their disposal, including those competent authorities have been required to put in place in accordance with Directive (EU) 2015/849. Competent authorities should ensure the reliability and continuity of these measures and tools to minimize the risk of a potential information void. In particular, competent authorities should refer to the ESAs Joint guidelines on cooperation and information exchange for the purpose of Directive (EU) 2015/849 between competent authorities supervising credit and financial institutions (JC 2019 81), the EBA Guidelines on cooperation and information between prudential and AML/CFT supervisors and Financial Intelligence Units



under Directive (EU) 2019/878 and the Multilateral Agreement between the European Central Bank and national competent authorities pursuant to Article 57a(2)(b) of Directive (EU) 2015/849.

22. Competent authorities should consider the extent and objective of their cooperation and information exchange with other stakeholders, which may determine the most effective way for this cooperation, as the same approach may not be suitable in all circumstances. This means that more frequent cooperation and exchange of information may be necessary with other competent authorities and prudential supervisors, which are involved in the supervisor of the same subject of assessment, than with Financial Intelligence Units, tax authorities and law enforcement agencies.
23. When cooperating and exchanging information with other stakeholders, including law enforcement agencies, tax authorities, and other bodies or agencies, competent authorities should do so to the extent possible under national law. Competent authorities should seek to exchange information with local tax authorities on various tax offences and mechanisms, which would help the competent authority to assess the resulting ML risks that the subjects of assessment or sectors may be exposed. It may also exchange information on possible preventative actions in this area.

## 4.2 Step 1 - Identification of risk and mitigating factors

### 4.2.1 General considerations

24. Competent authorities should identify and understand the risk factors that will affect each sector's and subject of assessment's exposure to the ML/TF risks.
25. When identifying ML/TF risk factors, competent authorities should draw on the EBA's guidelines on customer due diligence and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions under Articles 17 and 18(4) of Directive (EU) 2015/849<sup>8</sup>.
26. Where subjects of assessment are clusters, competent authorities should identify relevant factors based on those listed in paragraphs 43 and 44 to characterise the cluster as a whole. This should enable competent authorities to justify their decisions on the risk profile they assign to the cluster. Competent authorities should also consider the results of previous supervisory actions in respect of subjects of assessment included within that cluster.

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<sup>8</sup> Consultation Paper on the draft guidelines under Articles 17 and 18(4) of Directive (EU) 2015/849 on customer due diligence and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions (JC 2019 87)



27. Where a subject of assessment is supervised by multiple competent authorities within one Member State, those competent authorities should cooperate and exchange information on that subject of assessment in order to develop a common understanding of its risk exposure.
28. The extent and type of information sought by competent authorities to identify risk factors and mitigating factors should be proportionate to the nature and size, where known, of the subjects' of assessment business activities. It should also take into account the subjects of assessment risk profile as determined on the basis of previous risk assessments, if any, and the context in which the subject of assessment operates, such as the nature of the sector to which the subject of assessment belongs. Competent authorities should consider setting out:
- a) what information they will always require in respect of subjects of assessment and require similar information for comparable subjects of assessment,
  - b) where and how they will obtain this information; and
  - c) the type of information which will trigger a more extensive and in-depth information request.

#### **4.2.2 Sources of information**

29. Competent authorities should identify risk factors in respect of sectors, sub-sectors, if relevant, and subjects of assessment based on information from a variety of sources. Competent authorities should determine the type and number of these sources on a risk-sensitive basis. Competent authorities should ensure that they have access to appropriate sources of information and take steps, where necessary, to improve these. Competent authorities should also ensure that they have implemented processes and procedures for collecting the necessary data.
30. The sources of information that competent authorities should always consider :
- e) The European Commission's supranational risk assessment published in accordance with Article 6(1) of Directive (EU) 2015/849;
  - f) The EBAs' Opinion on the ML/TF risk affecting the Union's financial sector published in accordance with Article 6(5) of Directive (EU) 2015/849;
  - g) the national risk assessment (NRA) of the Member State and other Member States as referred to in Article 7(1) of Directive (EU) 2015/849;
  - h) Delegated Acts adopted by the European Commission as referred to in Article 9(2) of Directive (EU) 2015/849;
  - i) national and foreign governments;
  - j) Outcomes of the EBA's risk assessments as referred to in Article 9a of Regulation (EU) No 1093/2010;
  - k) other competent authorities
  - l) AML/CFT supervisory authorities in third countries;



- m) supervisory authorities responsible for the supervision of subjects of assessment' compliance with prudential requirements, including competent authorities as defined in points (2)(i) and (viii) of Article 4 of Regulation (EU) No 1093/2010, points (2)(i) of Article 4 of Regulation (EU) No 1094/2010, and points (3)(i) of Article 4 of Regulation (EU) No 1095/2010;
- n) the Financial Intelligence Units (FIUs);
- o) law enforcement agencies, where not excluded by the applicable law; and
- p) tax authorities, where not excluded by the applicable law;
- q) AML/CFT colleges, established in accordance with the ESAs Joint Guidelines on cooperation and information exchange for the purpose of Directive (EU) 2015/849 between competent authorities supervising credit and financial institutions (the AML/CFT Colleges Guidelines)<sup>9</sup>, where established;

31. Other sources of information competent authorities should also consider include:

- a) EBA's AML/CFT central database as referred to in Article 9a (1) and (3) of Regulation (EU) No 1093/2010, when the information is made available to the competent authority;
- b) colleges of prudential supervisors, set up in line with Article 51 or 116 of Directive (EU) 2019/878 and with the Commission Implementing Regulation (EU) 2016/99 of 16 October 2015 on the operational functioning of colleges of supervisors, and the Commission Delegated Regulation (EU) 2016/98 of 16 October 2015 on the general conditions for the functioning of colleges of supervisors, where established.
- c) industry bodies, such as typologies and information on emerging risks;
- d) civil society such as corruption perception indices;
- e) international or supra-national standard-setting bodies such as mutual evaluations of countries' AML/CFT, anti-corruption and tax regimes;
- f) publicly available information from reputable sources;
- g) reputable commercial organisations such as risk and intelligence reports;
- h) whistleblowing reports
- i) Information from academic institutions; or
- j) external auditors' reports in respect of the subject of assessment, where they are available.

### 4.2.3 Domestic risk factors

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<sup>9</sup> ESAs Joint Guidelines on cooperation and information exchange for the purpose of Directive (EU) 2015/849 between competent authorities supervising credit and financial institutions (JC 2019 81)





32. Competent authorities should have adequate knowledge, awareness and understanding of the ML/TF risks identified at the national level in order to identify the ML/TF risk factors associated with the domestic activities of subjects of assessment and within sectors.
33. As part of this, and based on the sources described in paragraphs 30 and 31, competent authorities should understand, among other things:
- a) the type, typologies and scale of money laundering linked to predicate offences, including tax offences, committed domestically;
  - b) the scale of laundering of proceeds from predicate offences, including tax offences, committed abroad;
  - c) the type, typologies and scale of terrorism financing and the scale of, and the level of support for, terrorist activities and groups in the country;
  - d) relevant ML/TF typologies identified by the FIU and other public authorities or relevant bodies.

#### **4.2.4 Foreign risk factors**

34. Where a subject of assessment or a sector as a whole maintains significant links with other Member States or third countries so that the subject of assessment or sector is exposed to ML/TF risks associated with these other countries, competent authorities should identify these risks. Significant links include those where:
- a) a subject of assessment maintains significant level of business relationships with customers from other Member States or third countries;
  - b) a beneficial owner of a customer of the subject of assessment is from other Member States or third countries;
  - c) a subject of assessment is carrying out significant levels of occasional transactions with other Member States or third countries;
  - d) a subject of assessment maintains significant business relationships with counterparties established in other Member States or third countries;
  - e) a subject of assessment forms part of a financial group established in another Member State or third country;
  - f) a subject of assessment's beneficial owners are based in another Member State or third country;
  - g) a subject of assessment's managing body is comprised of individuals from another Member State or third country; and
  - h) a subject of assessment has any other relevant links to another Member State or third country, which means that it is exposed to the ML/TF risk associated with that country.



35. Competent authorities should take reasonable steps to acquire and keep up to date adequate knowledge, awareness and understanding of the ML/TF risks associated with these Member States or third countries that may affect the activities carried out by the subjects of assessment. To this end, competent authorities should identify risk factors in line with the EBA's AML/CFT Risk Factors Guidelines<sup>10</sup> and those described in paragraphs 32 and 33 above for each of these Member States or third countries.
36. When identifying third countries which have strategic deficiencies in their national AML/CFT regimes that pose significant threats to the financial system of the European Union, competent authorities should have regard to the delegated acts adopted by the European Commission in accordance with Article 9(2) of Directive (EU) 2015/849 as well as public statements issued by relevant international standard-setters, including the Financial Action Task Force (FATF), the European Council's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL) or other FATF-style regional bodies (FSRBs).

#### 4.2.5 Sector-wide ML/TF risk factors

37. Competent authorities should have a good understanding of the risk factors that are relevant for all sectors under their supervision. In order to identify relevant risk factors in the relevant sectors, competent authorities should first define the sectors under their supervision. To inform their view of the sectors, competent authorities should refer to the categories of obliged entities listed in Directive (EU) 2015/849, which are credit institutions, credit providers (other than credit institutions, for example consumer credit, factoring, leasing, mortgage credit and commercial credit), life insurance undertakings, life insurance intermediaries, e-money institutions, payment institutions, bureaux de change, investment firms and collective investment undertakings.
38. Depending on the size of a sector and the nature of subjects of assessment within it, competent authorities should consider dividing sectors further into sub-sectors. This may be necessary when a sector is made up of subjects of assessment that are very diverse because a substantial proportion of subjects of assessment share similar features and business models that set them apart from the rest of the sector. Similar features include, but are not limited to, the type of products and services offered, the delivery channels used and the type of customers they service. Sub-sectors may include money remitters, private banks, and brokerage firms, which represent sub-sectors of payment institutions, credit institutions and investment firms, respectively. To inform their view on sectors and sub-sectors and their specific features, competent authorities should refer to the Title II of the EBAs AML/CFT Risk Factors Guidelines.
39. Competent authorities should understand how each sector and sub-sector is organised, and the risks associated with shared features such as the type of products and services offered, the

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<sup>10</sup> Consultation Paper on the draft guidelines under Articles 17 and 18(4) of Directive (EU) 2015/849 on customer due diligence and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions (JC 2019 87)



delivery channels used and the type of customers they service. Competent authorities should base their understanding of the sectoral and sub-sectoral risk factors on:

- a) a high-level view of all relevant information related to subject of assessment in a particular sector or sub-sector as set out in paragraphs 43 to 48 in these guidelines in order to identify commonalities within each sector and sub-sector as a whole; and
- b) relevant information related to the sectors and sub-sectors as set out in paragraphs 40 to 42 in these guidelines.

#### **4.2.6 Type of information necessary to identify risk factors**

##### **a. Information on sectors**

- 40. Competent authorities should gather sufficient, relevant and reliable information from the sources described in paragraphs 30 and 31 to develop an overall understanding of the inherent risk factors and factors that mitigate these risks within the sector and sub-sector, where relevant.
- 41. In order to develop a good understanding of the inherent risk factors within the sectors and sub-sectors, competent authorities should obtain information which should include, but not be limited to:
  - c) information on the size, scope of activities, and complexity of the sector in an aggregated format;
  - d) the nature of the business models within the sector;
  - e) general information on the type of products, services, customers and delivery channels used within the sector or sub-sector and their risk profiles, if known
  - f) information on the current and emerging risks associated with the sector or sub-sector domestically and internationally, including the information that may indicate that the sector or sub-sector may be exposed to increased ML/TF risk as a result of de-risking practices applied to these sectors or sub-sectors by other sectors;
  - g) information on the main ML/TF risks affecting the internal market;
  - h) the impact of cross border activities within the sector or sub-sector;
  - i) the sector's or sub-sector's exposure to vulnerabilities that arise in a global context; and
  - j) threat reports, alerts and typologies from Financial Intelligence Unit;
  - k) Guidance published by other competent authorities or international standard setters;
- 42. The information described above can also contribute to the competent authorities' perception of risk factors on the level of individual subjects of assessment and vice versa.

##### **b. Information on subjects of assessment**



43. Based on the sectoral risk assessment, competent authorities should gather sufficient, relevant and reliable information from the sources described in paragraphs 30 and 31 to develop an overall understanding of the subjects' of assessment inherent risk factors, and, to the extent possible, residual risk factors.
44. In order to develop a good understanding of the inherent risk factors applicable to subjects of assessment, competent authorities should gather information from various sources that includes, but is not limited to the information relating to:
- a) the ownership and corporate structure of the subjects of assessment, taking into account whether the subject of assessment is a foreign or domestic credit institution or financial institution, parent company, subsidiary, branch or other kind of establishment, and the level of complexity and transparency of its organisation and structure.
  - b) the reputation and integrity of senior managers, members of the management body and qualifying shareholders;
  - c) the nature and complexity of the products and services provided and the activities and transactions carried out;
  - d) the delivery channels used, including the provision of services through non-face-to-face channels and the use of agents or intermediaries;
  - e) the types of customers serviced by the subject of assessment and the level of risk associated with those customers, including customers that are PEPs and those assessed as presenting heightened ML/TF risk according to the subject of assessment risk assessment methodology;
  - f) the geographical area of the business activities, in particular where they are carried out in high-risk third countries<sup>11</sup>, as well as, if applicable, the countries of origin or establishment of a significant part of the subject of assessment's customers and the geographical links of its qualifying shareholders or beneficial owners;
  - g) the authorisations, licensing or passporting by the subject of assessment .
45. In order to develop a good understanding of residual risk factors to which that have been implemented by subjects of assessment are exposed, competent authorities should gather information from different sources that includes, but is not limited to the information in respect of:
- a) the adequacy of mitigating measures put in place by a subject of assessment and in particular information
    - i) relating to the adequacy of the risk management framework, including the ML/TF risk management;

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<sup>11</sup> Consultation paper on the EBA Guidelines under Article 17 and 18(4) of Directive (EU) 2015/849 on simplified and enhanced customer due diligence and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions (JC 2019 87)\_



- ii) from the internal controls function reports, including internal audit, where relevant.
  - iii) related to the prudential and general aspects of the subject of assessment's business, such as years in operation, liquidity or capital adequacy;
  - iv) findings from off-site reviews carried out by the competent authority, other relevant competent authority, prudential supervisors or other relevant supervisory authority, including AML/CFT authorities in third countries.
- b) the effectiveness of mitigating measures put in place by a subject of assessment, in particular information in respect of:
- i) the quality of internal governance arrangements and structures, including the adequacy and effectiveness of internal audit and compliance functions, reporting lines, the level of compliance with AML/CFT legal and regulatory requirements and the effectiveness of the AML/CFT policies and procedures to the extent that these are already known;
  - ii) the prevailing 'corporate culture', particularly the 'compliance culture' and the culture of transparency and trust in relations with the competent authorities;
  - iii) findings from previous supervisory inspections carried out by the competent authority, other relevant competent authority, prudential supervisors or other relevant supervisory authority, including AML/CFT authorities in third countries that involve certain on-site elements and testing;
  - iv) pending or imposed supervisory measures and sanctions related to the subject of assessment taken by the competent authority, prudential supervisors or other relevant supervisory authority, including in third countries;
  - v) Information received from Financial Intelligence Units, such as the information related to suspicious transactions reports.
46. Where competent authorities consider that the information gathered through sources described in paragraphs 30 and 31 is not available or is insufficient to develop a good understanding of risks associated with the subject of assessment, competent authorities should consider collecting such information directly from the subjects of assessment.
47. Where information for the individual risk assessment is gathered directly from subjects of assessment, competent authorities should ensure that the type of information requested is determined by the relevant domestic, foreign and sector-wide risk factors as set out in these guidelines, including emerging risks.
48. Competent authorities should consider adjusting the level and frequency of information requested from subjects of assessment on a basis of the level of the risk associated with the sector or sub-sector that the subject of assessment belongs to. This means that information related to the sectors that are exposed to more significant levels of ML/TF risks may be collected more frequently than in respect of sectors with less significant levels of risk. When



determining the level and frequency of the information requests, competent authorities should consider:

- a) whether some of the information requested is available to the competent authority from other sources, including prudential supervisors, to reduce the duplication of information requests;
- b) the purpose for which the information will be used. If the information is requested to inform the competent authority's assessment of risks associated with a subject of assessment or the sector, then the competent authority should consider aligning the frequency of information requests with the frequency of updates to the risk assessment;
- c) whether there have been any significant changes to the level of ML/TF risk associated with the subject of assessment or the sector, which would indicate the need for more frequent information requests.

## 4.3 Step 2 - Risk assessment

### 4.3.1 General considerations

49. Competent authorities should take a holistic view of the ML/TF risk factors they have identified under Step 1 that, together, will form the basis for the individual risk assessments of subjects of assessment and the sectoral risk assessments.
50. When drawing up their risk assessment methodology, competent authorities should consider how sectoral and individual risk assessments interact. The sectoral risk assessment provides competent authorities with an overall view of the ML/TF risks to which subjects of assessment in a particular sector are exposed, and the relevance of individual risk factors to subjects of assessment in this sector. Through individual risk assessments, competent authorities should be able to assess the impact of sectoral risks on each subject of assessment, while at the same time using those risk assessments to update and review their sectoral risk assessments as appropriate, including by identifying new risk factors that are common to subjects of assessment in the sector.

### 4.3.2 Sectoral and sub-sectoral risk assessment

51. Competent authorities should develop a good understanding ML/TF risks present in each sector under their supervision, which will allow them to prioritise their supervisory activities across and within sectors and to identify ML/TF risks that are relevant for a particular sector. The sectoral risk assessment should provide competent authorities with the basis for the overall risk assessment process, by developing their understanding of the inherent risks within the sector to which subjects of assessment are exposed to inform the competent authority's understanding of the extent of supervisory attention needed in the sector. Competent authorities should decide whether they have sufficient, reliable information on controls within the sector to carry out the assessment of residual risk.



52. Competent authorities should ensure that the sectoral risk assessment is sufficiently comprehensive and enables the supervisor to obtain a holistic view of all relevant risk factors, and the extent to which they affect subjects of assessment in each sector.
53. In order to perform sectoral risk assessment, competent authorities should first define the sectors and sub-sectors, where relevant, under their supervision as described in paragraphs 37 to 39 above.
54. When carrying out the risk assessment of the sector as a whole or of the sub-sector, if relevant, competent authorities should perform an assessment of the sector-wide risk factors identified in line with Step 1 of the RBS model. Competent authorities should base their assessment on the information gathered in line with paragraphs 40 to 42 above.
55. As part of this process, competent authorities should consider allocating different weights to different risk factors as described in paragraphs 63 and 64 of these guidelines, to reflect the degree of impact that various ML/TF threats have on the particular sector.

#### **4.3.3 Individual risk assessments**

56. Competent authorities should develop a comprehensive understanding of the inherent risks and, where feasible, of residual risks to which subjects of assessment are exposed. To that end, they should carry out individual risk assessments of each subject of assessment. Competent authorities should use all relevant sources to gather the necessary information for the individual risk assessments as described in paragraphs 43 to 49 above.
57. In order to achieve a comprehensive understanding of risks associated with individual subjects of assessment, competent authorities should establish and maintain ongoing process and methodology for assessing and reviewing risks associated with the subjects of assessment. When developing their risk assessment processes, competent authorities should:
  - a) be guided by the outcome of the assessment of risks within the sector or sub-sector to which the subject of assessment belongs. In essence, with the sectoral or sub-sectoral risk assessment, the competent authority will have already identified the main inherent risks to which individual subjects of assessment within a given sector or sub-sector are exposed.
  - b) determine how they will assess the relevant inherent risk factors identified under Step 1 of the RBS model that affect the subject of assessment.
  - c) gather the necessary information that allows them to understanding the subjects' of assessment exposure to customer, products and services, geographical and distribution channel risks. This means that competent authorities should consider whether the same information is required in respect of all subjects of assessment. Where information is gathered from the subjects of assessment, please refer to the section on the 'Quality Assurance' in these guidelines for additional safeguards that should be put in place.



58. Where, on a basis of information set out in paragraph 45 b) in these guidelines, competent authorities have developed a sufficient understanding of mitigating measures put in place by subjects of assessment, they should carry out the assessment of the residual risk in respect of those subjects of assessment. However, where such information is not available or is not sufficiently comprehensive, competent authorities should revert to the inherent risk assessment in respect of those subjects of assessment. When assessing the residual risk factors, competent authorities should assess the extent to which the AML/CFT systems and controls, which the subject of assessment has in place, are adequate to effectively mitigate the inherent risks to which it is exposed. As part of this, competent authorities should assess at least:

- a) that the AML/CFT systems and controls listed in Article 8(4) of Directive (EU) 2015/849 are put in place and applied. These controls should be sufficiently comprehensive and commensurate to the ML/TF risks
- b) that wider governance arrangements and risk management processes, including overall risk culture, are adequate and effective.

59. Competent authorities should determine how to incorporate their professional judgment in their risk assessment work.

#### **4.3.4 Assessment of the ML/TF risks at the group level**

60. Competent authorities, who are the lead supervisor in accordance with the ESAs Joint Guidelines on cooperation and information exchange for the purpose of Directive (EU) 2015/849 between competent authorities supervising credit and financial institutions (JC 2019 81) , should develop a holistic view of ML/TF risks to which subjects of assessment which are part of a group are exposed. This means that these competent authorities should develop a risk profile of the subject of assessment under their supervision, taking into account all relevant domestic and foreign risk factors. They should pay particular attention to the risks associated with a subject of assessment's cross-border operations and the business activities of parts of their group in other jurisdictions, which may have a bearing on the overall risk profile of the subject of assessment. In particular, the risk assessment should reflect at least the risks arising from the subject's of assessment exposure to countries:

- a) that have been identified by the European Commission's as having strategic deficiencies in their AML/CFT regime, in line with Article 9(2) of Directive (EU) 2015/849;
- b) where the law prohibits the implementation of group-wide policies and procedures and in particular if there are situations in which the Commission delegated Regulation (EU) 2019/758 should be applied;
- c) which, in accordance with credible and reliable sources<sup>12</sup>, are exposed to high levels of corruption or other predicate offences to ML;
- d) countries or territories where terrorist organisations are known to be operating; and

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<sup>12</sup> According to Consultation paper on the EBA Guidelines under Article 17 and 18(4) of Directive (EU) 2015/849 (JC 2019 87), the credibility of allegations can be determined on the basis of the quality and independence of the source of the data and the persistence of reporting of these allegations, among other considerations.





- e) where, according to information from more than one credible and reliable source, serious concerns have been raised about the effectiveness and quality of the jurisdiction's AML/CFT controls, including information about the quality and effectiveness of regulatory enforcement and oversight. In this case, credible and reliable sources may include mutual evaluation reports by the Financial Action Task Force (FATF) or FATF-style Regional Bodies (FSRBs), the FATF's list of high-risk and non-cooperative jurisdictions, International Monetary Fund (IMF) assessments and Financial Sector Assessment Programme (FSAP) reports.
61. To inform the risk assessment of subjects of assessment, which are part of a group, competent authorities, which are the lead supervisors, should cooperate and exchange relevant information with other competent authorities that are responsible for the AML/CFT supervision of parts of the group. For cross-border groups, if there is an AML/CFT college, the lead supervisor should make use of the information exchanged in the college to gather the necessary information for the risk assessment. Necessary information includes, in respect of branches or subsidiaries of subjects' of assessment, at least information related to:
- a) the ML/TF risk profile of branches or subsidiaries as assessed by relevant competent authorities in those jurisdictions;
  - b) the ML/TF risk profile of the sector that branches or subsidiaries as assessed by the relevant authorities in those jurisdictions,
  - c) findings from the competent authorities' assessments of the quality of controls in place within branches or subsidiaries of subjects of assessment;
  - d) serious breaches or material weaknesses in branches or subsidiaries identified by the relevant competent authorities in their jurisdictions;
  - e) any supervisory measures and sanctions imposed on branches or subsidiaries by relevant competent authorities in their jurisdictions.
62. When assessing whether subjects of assessment have implemented group-wide policies and procedures in their branches and subsidiaries effectively, competent authorities, which are the lead supervisor, should refer to the risk assessment in respect of these subjects of assessment described in paragraphs 58 and 59 of these guidelines and, in particular, the assessment of geographical risks to which branches and subsidiaries of subjects of assessment are exposed.

#### **4.3.5 Weighting risk factors**

63. Competent authorities should weight the risk factors for sectors and subjects of assessment identified under Step 1 of the RBS model, depending on their relative importance. In this regard, there are a number of considerations that competent authorities should take into account:
- a) when weighting inherent risk factors, competent authorities should make an informed judgement about the relevance of different factors in relation to a sector, sub-sector or individual subject of assessment. In respect of individual subjects of assessment, competent authorities should take into account their sectoral or sub-sectoral risk



assessment.

- b) that the weight given to individual risk factors can vary between sectors, sub-sectors or subjects of assessment, but competent authorities should use similar factors for similar sectors, sub-sectors or subjects of assessment.
- c) weighting of risks does not lead to a situation where it is impossible for a sector, sub-sector or subject of assessment to be classified as significant or very significant risk or where all sectors, sub-sectors or subjects of assessment fall within the same risk category.
- d) weighting is not unduly influenced by just one risk factor and that due consideration is given to factors that are identified by Directive (EU) 2015/849 or national legislation as always presenting a significant or high ML/TF risk. When weighting risk factors, competent authorities should ensure to avoid that one risk factor does not sway the balance of the overall weighting to a disproportionate and unreasonable assessment.

64. Where competent authorities use automated IT systems to allocate overall risk scores to subjects of assessment, and in particular in situations where they have not developed these in house but purchased them from an external provider or otherwise relied on external input, they should understand how the system works and how it combines or weighs risk factors to achieve an overall risk score. Competent authorities should always be satisfied that the scores allocated reflect their understanding of ML/TF risk associated with the subject of assessment.

#### **4.3.6 Risk profiles and categories**

65. The assessment of the inherent risk level and the effect on the inherent risk level by risk mitigants should result in the assignment of a risk score, where relevant, to the sector, sub-sector and subject of assessment to facilitate comparison between subjects of assessment and to inform the action they take in Step 3.

66. Competent authorities should ensure that the assessment of mitigants within the subject of assessment, sector or sub-sector is based on reliable information, such as the information set out in point b) of paragraph 45 above. In the absence of such information, competent authorities should consider whether the inclusion of mitigating factors is justified, and whether, as a result of the allocation of scores to mitigating factors, the final ML/TF risk score of the subject of assessment is not distorted.

67. Where competent authorities have only limited information about the mitigants within the subject of assessment or sector and sub-sector, they should categorise these subjects of assessment, sectors and sub-sectors on a basis of their inherent risk profile and assign the residual risk score when relevant information becomes available.

68. Competent authorities should use their professional judgement to validate the results of the overall risk assessment and correct it if necessary.

69. Competent authorities should decide on the most appropriate way to categorise the risk



profiles of subjects of assessment, sectors and sub-sectors. To achieve convergence and facilitate cooperation and information exchange between different competent authorities, competent authorities should consider classifying subjects of assessment, sectors and sub-sectors as 'very significant', 'significant', 'moderately significant' and 'less significant' in line with the EBA's ML/TF risk assessment processes.

70. Competent authorities should ensure that their risk assessment processes enable them to distinguish between inherent and residual risks. When categorising the inherent risk associated with subjects of assessment, sectors or sub-sectors, competent authorities should consider to the following risk categories:
- a) less significant risk, where the subject of assessment, sector or sub-sector is very unlikely to be abused extensively for ML/TF purposes;
  - b) moderately significant risk, where the subject of assessment, sector or sub-sector is unlikely to be abused extensively for ML/TF purposes;
  - c) significant risk, where the subject of assessment, sector or sub-sector is likely to be abused extensively for ML/TF purposes; or
  - d) very significant risk, where the subject of assessment, sector or sub-sector is very likely to be abused extensively for ML/TF purposes.
71. When categorizing the residual risk associated with subjects of assessment, sectors or sub-sectors, competent authorities should consider the impact that mitigating measures may have on the inherent risk associated with subjects of assessment, sectors and sub-sectors. The four risk categories should be applied by competent authorities to categorise residual risk as follows:
- a) less significant risk, where the inherent risk is less significant and the risk profile remains unaffected by mitigation, or where the inherent risk is moderately significant or significant, but is effectively mitigated through AML/CFT systems and controls;
  - b) moderately significant risk, where the inherent risk is moderately significant and the risk profile remains unaffected by mitigation, or where the inherent risk is significant or very significant, but is effectively mitigated through AML/CFT systems and controls;
  - c) significant risk, where the inherent risk exposure is significant and the risk profile remains unaffected by mitigation, or where the inherent risk is very significant but is effectively mitigated through AML/CFT systems and controls; or
  - d) very significant risk, where the inherent risk is very significant and, regardless of the mitigation, the risk profile remains unaffected by mitigation, or where the inherent risk is very significant and is not effectively mitigated due to systemic AML/CFT systems and control weaknesses in the subject of assessment or in the majority of subjects of assessment in the sector.
72. Where competent authorities decide not to apply the risk classification set out in paragraphs 69, 70 and 71 above, they should be able to convert its risk categories in line with those



recommended in these guidelines. Competent authorities should adopt a conservative approach when converting the risk categories as described in Annex to these guidelines.

73. Competent authorities should note that the categorisation of subjects of assessment for ML/TF risk purposes may be different from categories applied to the same subjects of assessment for wider conduct risk or prudential risk purposes.
74. Where a competent authority uses an automated IT system to determine the risk profile or score of an individual subject of assessment, competent authorities should make allowance for situations where they may need to amend the results of the automated scoring on the basis of their professional judgment in addition to the review process set out in Step 4 of the RBS model. Competent authorities may decide to apply the professional judgment if there is information that suggests that the overall risk rating is not true reflection of reality, including information from Financial Intelligence Units, media reports or on-site and off-site supervision. The rationale for such changes to the risk profile or score should be clearly documented by the competent authority.

## 4.4 Step 3 – Supervision

### 4.4.1 General provisions

75. Competent authorities should ensure that subjects of assessment exposed to more significant ML/TF risks are subject to more frequent and intrusive supervision. Competent authorities should adjust their supervisory approach by adjusting one or more of the following elements:
- a) the nature of supervision, by adjusting the ratio between off-site and on-site supervisory tools.
  - b) the focus of supervision, by focusing on the overall AML/CFT framework in place at subjects' of assessment or by focusing on the management of specific ML/TF risks, including risks associated with particular products or services, or on specific aspects of the AML/CFT processes such as customer identification, risk assessment, ongoing monitoring and reporting activities;
  - c) the frequency of supervision, by ensuring that subjects of assessment that are exposed to more significant ML/TF risks are supervised more frequently than those subjects of assessment that are exposed to less significant risks; and
  - d) the intensity and intrusiveness of supervision, by determining, according to risk, the extent of customer file reviews, sample testing of transactions and suspicious transactions reports conducted on-site. Competent authorities should note that a review based only on an assessment of policies and procedures, rather than on their implementation, is unlikely to be sufficient in situations where the exposure to ML/TF risk is more significant.

### 4.4.2 Supervisory strategy



76. Competent authorities should determine and implement a longer-term AML/CFT supervisory strategy where they set out how they will mitigate the ML/TF risks they have identified.
77. The strategy should cover all sectors and sub-sectors, where relevant, and should be based on the sector-wide risk assessment carried out in accordance with Guideline 3.
78. In the strategy, competent authorities should set clear objectives for their approach to AML/CFT supervision and set out how these objectives will be achieved. As part of this, a supervisory strategy should:
- a) explain how they will work to mitigate the existing and emerging ML/TF risks identified in the sectors and sub-sectors under their supervision;
  - b) explain how they will ensure that adequate supervisory coverage and monitoring commensurate to the ML/TF risk is applied to all sectors and sub-sectors, including those associated with lower ML/TF risks. In particular, how they will ensure that sectors associated with more significant ML/TF risks will receive higher supervisory coverage;
  - c) set out the type of supervisory tools that competent authorities will use to tackle which types of risks;
  - d) a define inspection or review cycles (if any), per risk category and the type of supervisory tools applicable in each cycle;
  - e) determine the supervisory resources necessary to implement the strategy and ensure that sufficient resources are available to implement the supervisory strategy;
  - f) explain how competent authorities will tackle emerging risks when they arise.

#### **4.4.3 AML/CFT supervisory plan**

79. Competent authorities should determine and put in place a supervisory plan that implements its supervisory strategy. Competent authorities should decide on the period of time covered by their supervisory plan, taking into account wider organisational constraints as appropriate. Competent authorities should coordinate all supervisory plans that cover the period of time covered by the supervisory strategy, to ensure balance between them and that together they serve to implement the supervisory strategy.
80. In the supervisory plan, competent authorities should clearly set out the supervisory tools that they will apply to subjects of assessment in order to achieve their objectives and in line with their strategy. Individual risk assessment enables the competent authorities to fine-tune their choice of supervisory tools for a specific subject of assessment targeting risks specific to that subject of assessment.
81. Competent authorities should set out in the plan how they will allocate supervisory resources to subjects of assessment in a way that is commensurate with the subjects' of assessment risk profile developed in line with Guideline 3.



82. Competent authorities should recognise that subjects of assessment exposed to significant or very significant levels of ML/TF risk may not be systemically important. Therefore, when deciding on the most appropriate AML/CFT supervisory tools, competent authorities should refer to their ML/TF risk assessment and should not rely on their prudential or conduct risk assessments, where available, nor should they consider only systemically important subjects of assessment. Competent authorities should note that it may not be appropriate to draw conclusions, for AML/CFT supervisory purposes, from the level of prudential or conduct risk.
83. Competent authorities should ensure that the AML/CFT supervisory plan is independent from the prudential supervisory plan. Although, at times, there might be overlaps in the subjects of assessment inspected by competent authorities and prudential supervisors and joint supervisory tools may be applied. However, competent authorities are responsible for ensuring that the AML/CFT supervisory objectives are fully met as a result of these joint actions.
84. When developing the AML/CFT supervisory plan, competent authorities should ensure that it provides for contingencies in cases where new risks are identified in the course of on-site or off-site supervision, which require competent authorities to respond in an appropriate and timely fashion. This may result in the amendments to the initial AML/CFT supervisory plan in order to adapt to the new circumstance and ML/TF risks. This may include a change from off-site review to an on-site inspection or a change from a thematic review to a full scope inspection. Competent authorities should adequately document any changes to the AML/CFT supervisory plan, explaining how and when the supervision of those subjects of assessment affected by the changes to the plan will be carried out.

#### **4.4.4 Supervisory tools**

85. Competent authorities should have a good understanding of all supervisory tools available to them to implement their supervisory strategy and plan. They should develop understanding of the advantages and disadvantages associated with each supervisory tool, and consider how to use effectively the full range of supervisory tools at their disposal. The supervisory tools may include, but are not limited to, full scope on-site inspections, ad-hoc inspections, thematic inspections, AML/CFT returns, follow up inspections, off-site reviews and the guidance to the sector.
86. When selecting the most appropriate supervisory tool for subjects of assessment, competent authorities should always have the end goal in mind. In order to choose the most effective supervisory tool to address a specific supervisory need or objective, competent authorities should refer to their sectoral and individual ML/TF risk assessments and should also consider:
- a) the number of subjects of assessment and sectors under the competent authority's supervision;
  - b) specific features of different supervisory tools when applied on their own or in combination with each other;
  - c) the resources needed to apply different supervisory tools;



- d) the time needed for the supervisory tool to achieve its purpose and to have an impact on the subjects' of assessment AML/CFT compliance.
87. Competent authorities should exercise flexibility and adapt their use of supervisory tools in response to a new or emerging ML/TF risk identified within the subject of assessment, sector or sub-sector. Such situation may arise where the competent authority has identified through AML/CFT returns or other supervisory activities an emerging ML/TF risk, which may require further assessment through an off-site review or on-site inspection.
88. Competent authorities should also be flexible to carry out ad hoc inspections where necessary, which do not form part of their supervisory strategy and plan. Such inspections may be triggered by a specific event, ML/TF risk or happen as a result of discovery of certain information by the competent authority, including whistleblowing reports, wide-spread public allegations of wrongdoing, a new ML/TF typology or supervisory findings relating to AML/CFT systems and controls or a wider internal controls framework. Where the competent authority has decided that an ad hoc inspection is warranted, it should determine the scope of the inspection, the focus of the inspection and whether it will involve any on-site elements.
89. Competent authorities should recognise that each subject of assessment, sector and sub-sector is exposed to different levels of ML/TF risk, which should determine the type and frequency of supervisory tools used. To ensure efficient use of supervisory resources, competent authorities should choose tools which are likely to have a greater impact on the subjects of assessment' compliance, or allow them to cover a larger part of a sector. Where competent authorities are looking to develop a better understanding of the way specific ML/TF risks are managed by a sector, or particular types of subjects of assessment, they should consider using thematic reviews to achieve this.
90. In circumstances where competent authorities are looking to develop a deep understanding of the overall AML/CFT systems and controls framework within the subject of assessment, competent authorities should make use of the full-scope on-site inspections. These inspections include, at least, a review of subjects' of assessment AML/CFT policies and procedures and an assessment of their implementation through, inter alia, interviews with key personnel, testing of systems used in the AML/ CFT compliance and a review of risk assessment and customer files. Based on the scope and complexity of the subject's of assessment business, competent authority should consider whether the full scope on-site inspection will cover the entire business of the subject of assessment or whether it is more feasible to focus on a specific business line within the subject of assessment. Either on their own or in combination with other supervisory tools, competent authorities should consider using on-site inspections, in particular when supervising subjects of assessment that present a significant and very significant level of ML/TF risk.
91. Where the implementation of AML/CFT systems and controls by subjects of assessment is not the competent authority's key objective, competent authorities should consider the use of off-site reviews. Such reviews primarily involve a desk-based review of the subject's of assessment written AML/CFT policies and procedures and risk assessment, but does not involve a detailed



assessment of how effectively these policies and procedures have been implemented in practice by the subject of assessment.

92. In some instances, competent authorities should consider whether the combination of two or more tools may be more effective. This includes situations where the competent authority is concerned about the accuracy of information received during off-site reviews or as part of AML/CFT returns and decides to verify this information through an on-site inspection, either full scope or ad hoc, which generally contains such elements as sampling of transactions and customer files, and interviews with key personnel and members of the management body. Therefore, on-site inspections allow competent authorities to:
- a) develop a deeper understanding of the subject of assessment's overall approach towards AML/CFT, including practices, governance, staff behaviours and culture;
  - b) discuss potential risks, the results of supervisory activities, as well as problems which the subject of assessment might be facing and ways to solve them;
  - c) communicate their supervisory expectations.
93. When deciding whether to carry out a full-scope on-site inspection or use other type of supervisory tool, competent authorities should consider:
- a) whether there is a need to obtain additional information on the subject of assessment that may be obtained only through on-site elements;
  - b) what type of information is needed and how to obtain it effectively;
  - c) whether the outcomes of previous on-site inspections or off-site reviews carried out by the competent authority, if available, show poor levels of AML/CFT compliance or suggest poor compliance culture within the subject of assessment that may indicate the need for an on-site inspection;
  - d) whether subjects of assessment have previously demonstrated their commitment to fix the shortcomings and whether they have taken a robust action to do so;
  - e) whether subjects of assessment have previously breached their AML/CFT obligations and whether they have done so repeatedly; and
  - f) what type of supervisory follow up, if any, was previously applied by the competent authority to the subject of assessment.
94. Where, as a result of a scheduled, ad hoc or thematic inspection, competent authorities have identified weaknesses in the subjects' of assessment AML/CFT controls framework, competent authorities should consider whether a follow up inspection is needed to ensure that these weaknesses have been mitigated effectively. The scope and format of the follow up inspection will be determined by the type and extent of weaknesses identified and by the subject of assessment risk profile.





95. If a competent authority undertakes an inspections, which is carried out remotely through virtual means, as opposed to on-site inspections, the competent authority should consider the effectiveness of this supervisory tool and if the engagement meets the conditions for an on-site inspection. A competent authority should consider whether an on-site inspection is more appropriate when supervising subjects of assessment that present a significant or very significant level of ML/TF risk and, in circumstances, where competent authorities are looking to develop a deep understanding of the overall AML/CFT systems and controls framework within the subject of assessment.
96. Competent authorities, which are the lead supervisor, should consider the most effective supervisory tool to ensure that group-wide policies and procedures are implemented effectively by subjects of assessment, which are part of the group. As part of this, the lead supervisor should cooperate with other competent authorities involved in the supervision of subjects of assessment within the group through AML/CFT colleges, where they exist, or through other channels and cooperation mechanisms. This cooperation may consist of, but is not limited to:
- a) agreeing to apply a particular supervisory tool or supervisory action with other competent authorities, which are responsible for the supervision of other subjects of assessment within the group. This may involve carrying out an inspection or a review jointly with other competent authorities or by jointly adjusting the focus of a supervisory tool to mitigate risks that are cross-cutting across the group more effectively.
  - b) Exchanging information related to findings from inspections or reviews;
  - c) Exchanging information related to weaknesses or breaches identified by other competent authorities.
97. Competent authorities should have a holistic view of all supervisory tools applied by them. They should monitor their implementation and effectiveness and make adjustments where necessary.

#### **4.4.5 Supervisory practices and the supervisory manual**

98. To meet their obligations under Directive (EU) 2015/849, competent authorities should assess subjects of assessment's AML/CFT systems and controls, as well as the effectiveness of the systems and controls subjects of assessment have put in place to prevent and detect ML/TF . The steps competent authorities take to assess subject of assessment's AML/CFT systems and controls should be set out in a dedicated supervisory manual.
99. Formalising supervisory practices and methodologies as part of a supervisory manual allows competent authorities to ensure the application of the supervisory tools and professional judgment in a consistent way It should provide sufficient detail of all the activities the supervisors are required to undertake when assessing subjects of assessment's AML/CFT systems and controls, however it should also provide the supervisor with sufficient flexibility to make adjustments to the supervisory approach and use their expert judgement.



100. In the supervisory manual, competent authorities should outline the steps supervisors are required to take when applying different supervisory tools. The manual should set out at least:
- a) what process should be followed by supervisors when carrying out each supervisory tool and what areas should be tested. Competent authorities should clearly set out what are the key differences between the supervisory tools. This means that competent authorities should at least clarify the extent to which supervisory are expected to test:
    - i) the adequacy of relevant policies and procedures and whether they are linked to the business-wide risk assessment;
    - ii) that relevant processes have been put in place and that they operate as expected;
    - iii) the adequacy and completeness of the business-wide risk assessments and to what extent it determines the overall AML/CFT approach;
    - iv) the adequacy of customer risk assessments and the extent to which they determine the customers CDD;
    - v) adequacy of internal governance arrangements and internal reporting lines, in respect of AML/CFT compliance, including the quality and quantity of management information.
  - b) what type of engagements and communications should the supervisor have with the subject of assessment prior to, during and after the application of a particular supervisory tool;
  - c) how to assess that AML/CFT systems and controls put in place by subjects of assessment are effective enough and commensurate to the ML/TF risks that the subject of assessment is exposed. Competent authorities should at least set out the main areas on which the supervisor should focus which may suggest the lack of effectiveness within the subject of assessment. Some indicators that may suggest that the AML/CFT framework is implemented effectively include, but are not limited to:
    - vi) staff within the subject of assessment demonstrate good understanding of the parameters used for different systems and are able to explain the rationale for the outcomes from these systems;
    - vii) systems used to screen customers or transactions deliver the expected outcomes, which are in line with other similar subjects of assessment in a sector;
    - viii) staff at the subject of assessment demonstrate good understanding of AML/CFT policies and processes and how they are applied in practice;
    - ix) Various internal and external reports, such as internal and external audit or consultants, do not raise any concerns about the subject of assessment AML/CFT compliance;
    - x) Sufficient and relevant training is provided to all relevant staff and senior management within the subject of assessment;



- xi) Fair incentives practices, including remuneration and other rewards, have been implemented by the subject of assessment that do not directly or indirectly foster unsound work practices or culture;
  - xii) Sufficient and adequate management reporting throughout all levels of management;
  - xiii) Adequate governance arrangements have been put in place with a clear role of the senior management within the AML/CFT framework.
- d) including the extent to which the supervisor is expected to challenge the robustness of AML/CFT controls, the implementation of policies and procedures and the effectiveness of the business-wide risk assessment, i
- e) examples of the type of situations where the supervisors are expected to apply their supervisory judgment;
- f) where a supervisory tool includes sampling of customer files or transactions, the manual should explain the sampling methodology, including the minimum sample size and criteria for selecting a sample. and
- g) the governance arrangements within the competent authority for approval of the outcomes from inspections or reviews.
101. When developing their sampling policy, competent authorities should be mindful that subjects of assessment differ in many ways, such as the number and type of products and services and the number and type of customers and transactions. This means that sampling may need to be tailored by competent authorities for a particular subject of assessment. As part of this, competent authorities should consider at least the following criteria for selecting a meaningful sample:
- a) that sampling will addresses the objectives of a particular supervisory tool, which is being used for the assessment. This means that, while the sample should be made up of a meaningful amount of customer files or transactions that represent the diversity of customers, products and services in different risk categories, the size and composition of a sample for a specific subject of assessment will be determined by:
    - i) the goal of the supervisory tool;
    - ii) different risk categories of customers and the proportion of customers that represent significant or very significant ML/TF risk;
    - iii) the nature, size and complexity of the subject assessment and its business.
  - b) that checks performed as part of sampling enable the competent authority to achieve the desired supervisory goal; and
  - c) Competent authorities should find the right balance between sampling and other supervisory activities that form part of the supervisory tool, such as reviewing the general systems, governance and policies and procedures.



102. Competent authorities sampling policy should be flexible and allow for adjustments on a basis of the level of risk or new information, including information obtained as part of their supervisory activities. This may include changing the size of the sample, the categories customers, products, services or transactions included in the sample or the specific checks performed. Where sampling suggests a systemic failure on behalf of the subject of assessment, competent authorities should investigate the root cause of this failure.
103. The supervisory manual should be reviewed regularly and updated when necessary, in particular if there have been some significant changes that may have an impact on the supervisory approach, including changes introduced by the legal framework or international guidance, or changes required as a result of the feedback received by the competent authority on the adequacy of its supervisory approach, including internal audit function or external bodies. As a result of this review, competent authorities should take stock of lessons learnt and address any shortcomings identified, if any. Relevant staff at the competent authority should be made aware of any changes to the manual without delay.

#### **4.4.6 Quality assurance**

104. In order to achieve consistency in supervision, competent authorities should put in place quality assurance checks to ensure the consistent application of the supervisory tools and practices by all supervisors in line with the supervisory manual. Such checks should include, at least, internal audit and a four-eye principle. Competent authorities should also use staff training, mentoring and work shadowing between staff members as other means of achieving supervisory consistency.
105. Competent authorities should ensure the accuracy and reliability of information gathered from subjects of assessment for the purposes of the risk assessment or other supervisory tools. To ensure this, competent authorities should cross-check the information at least against the information:
- a) In respect of the subject of assessment available to the competent authority or prudential supervisors;
  - b) received from Financial Intelligence Units or other reliable sources;
  - c) collected from other similar subjects of assessment.
106. Where competent authorities have identified that the information provided by one or more subjects of assessment appears to be inaccurate or incomplete, they should take steps to clarify the information or to obtain accurate information. In such circumstances, competent authorities should determine the potential supervisory action based on the extent and type of inaccuracies identified. The actions may include, requesting clarifications directly from the subject of assessment, carrying out an ad-hoc inspection on the subject of assessment or imposing supervisory measures.



107. Competent authorities should consider the resources required when designing and carrying out the necessary quality assurance checks. In some instances, it may be necessary to involve IT or other specialised resources.

#### **4.4.7 External parties**

108. Where competent authorities use experts from external consultants or auditors for the execution of their supervisory plan or certain parts of the plan, they should always ensure that experts:

- a) have sufficient knowledge and skills, to carry out the specific supervisory tasks such as inspections and reviews;
- b) have a clear understanding of regulatory expectations and the scope of the work required to be undertaken by the competent authority;
- c) have access to specific guidance that sets out clearly the terms of their involvement, as well as any processes that have to be followed;
- d) keep sufficient records detailing the steps taken to carry the required tasks and explaining the rationale for their conclusions and findings;
- e) carry out the required tasks to a high quality standard. This may involve competent authorities participating in some of the meetings or inspections that are carried out by the experts;
- f) declare any potential conflicts of interest and, if it transpires that conflicts of interest exist, competent authorities should ensure that they are adequately managed and resolved. Where it is not possible to resolve the conflicts of interest, the competent authority should refuse or terminate the engagement with the specific expert.

109. Where competent authorities use experts consistently, this should be reflected in the competent authorities supervisory plan and manual.

110. Competent authorities should ensure that they maintain sufficient in-house expertise to be able to review and sufficiently challenge, if necessary, the work carried out by the experts.

111. Where subjects of assessment engage external auditors or consultants to carry out an assessment of their compliance with AML/CFT obligations, either on their own initiative or upon request by the competent authorities, competent authorities should ensure that they are:

- a) notified of the scope of the review carried out by the external parties;
- b) notified of the skills, knowledge and experience of the experts; and
- c) updated regularly on the outcomes and findings of the experts' work, including where the experts consistently report the absence of weaknesses or findings.

112. Where there are doubts as to the overall quality of the work of the experts, competent authorities should consider reviewing the work carried out by the experts as part of their



inspections or reviews within the subject of assessment. Competent authorities should ensure that there are gateways put in place to ensure that the experts are able to report irregularities, weaknesses or breaches within the subject of assessment directly to the competent authority, if necessary.

113. Competent authorities should consider the work of external auditors and consultants, and should reflect it in their supervisory follow-up or as part of their ongoing supervision as necessary. Competent authorities should analyse the reasons for any discrepancies identified between expert report and findings from supervisory inspections or reviews and reflect this analysis in their risk assessment of the subject of assessment.

#### **4.4.8 Supervisory follow up**

114. Where competent authorities, as a result of the application of their supervisory tools, have identified breaches or weaknesses in the subjects of assessment AML/CFT systems and controls frameworks, they should take all necessary steps to ensure that these breaches or weaknesses are adequately addressed and effectively remediated by the subject of assessment and, that as a result of these steps, subject of assessments' behaviors will change or discontinue.
115. When deciding on the most effective supervisory follow up, competent authorities should choose supervisory tools or measures that are proportionate to the materiality of weaknesses and seriousness of breaches identified and take into consideration the level of risk that the subject of assessment is exposed to. This means that serious breaches and material weaknesses<sup>13</sup> identified in a significant or very significant risk subject of assessment will require more intense follow up and more supervisory resources than less serious breaches or non-material weaknesses in less significant risk subjects of assessment.
116. When determining the most effective supervisory follow up, competent authorities should consider at least whether:
- a) to use one or a combination of supervisory tools, supervisory measures or sanctions to ensure that breaches and shortcomings within the subject of assessment are addressed and remediated in a most effective and timely manner; some breaches or weaknesses require more urgent action by the subject of assessment, which means that the competent authority should ensure that sufficient priority is given by the subject of assessment to remediate these shortcomings;
  - b) in some instances, where the remediation of a breach or shortcoming may take a long time, the subject of assessment should put in place a temporary measure to temporarily mitigate the risk;
  - c) there is a probability that a breach or weakness may happen again. Where the competent authority has identified a systemic failure at the subject of assessment by looking at the previous failures within the subject of assessment and the length of time for which the

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<sup>13</sup> For more details on how to determine the materiality of weaknesses, refer to the Regulatory Technical Standards developed by the EBA under Article 9a of the EBA Regulation



subject of assessment failed to implement effective systems and controls, the competent authority's follow up should focus not just on fixing one specific issue but on ensuring the discontinuation of the systemic failure by the subject of assessment.

- d) the subject of assessment is able and willing to remediate the failure identified by the competent authority, including the extent to which the key function holders and senior management within the subject of assessment are involved in the remediation process. Where the competent authority has suspicion that the failure to implement effective systems and controls may be deliberate, a more robust follow up action may be required to ensure an immediate cessation of such behaviour by the subject of assessment. In such circumstances, competent authorities should cooperate and exchange information on the failures within the subject of assessment with prudential supervisors.

117. Competent authorities should formalise their supervisory follow up process and set it out in their supervisory manual, while allowing sufficient flexibility for the supervisory judgement. Competent authorities should establish a timeline and a description of the concrete supervisory follow-up actions and measures to be taken by the subject of assessment to address each breach or weakness.

118. Competent authorities should ensure that breaches or weaknesses identified as a result of its supervisory tools are sufficiently remediated by the subject of assessment. Competent authorities should request a written remediation plan where the subject of assessment has set out its proposal to address the identified breaches and weaknesses. The remediation plan should set out a clear timeline for when the remediation will be complete, which should be challenged by the competent authority where the timeline is unrealistic. Competent authorities should be satisfied that after the implementation of the proposed action plan by the subject of assessment, all breaches and weaknesses will be effectively remediated.

119. Where competent authorities have identified that the subject of assessment has failed to implement its group-wide policies and procedures effectively in all parts of the group in accordance with Article 45(1) of Directive 2015/849 and that its systems and controls are not sufficiently robust to mitigate the risk that the group is exposed to in different jurisdictions, the competent authority should take necessary steps to ensure that:

- a) the subject of assessment has put in place a remediation plan at the group level setting out how it will mitigate the identified weaknesses in different jurisdictions;
- b) cooperate with other competent authorities involved in the supervision of the group entities without delay to ensure that they are made aware of these weaknesses either through AML/CFT colleges or through other cooperation mechanisms; and
- c) cooperate with other competent authorities to decide on the most appropriate follow up action, either at a group or individual entity level, as necessary. Such follow up may involve, among other supervisory tools, a joint on-site inspection between different competent authorities.



120. While supervisory follow-up process is separate from the sanctioning process, the two processes are not mutually exclusive and should supplement each other. Therefore, irrespective of the sanctions to be imposed on a subject of assessment, competent authorities should closely follow-up to ensure that breaches and shortcomings are sufficiently remediated.

121. In addition to their responsibilities to act on the breaches and weaknesses as set out in these guidelines, competent authorities have an independent duty to report these weaknesses to the EBA in accordance with the draft regulatory technical standards under Article 9a of Regulation (EU) No 1093/2010.

#### **4.4.9 Feedback to the sector**

##### **a. Feedback on the risk assessment**

122. Competent authorities should provide feedback to subjects of assessment on the outcomes of their sectoral risk assessment. Competent authorities should disclose at least:

- a) the key risks they have identified in each sector and sub-sector;
- b) their assessment of these risks; and
- c) any other information that may enhance the subjects' of assessment understanding of risks and enhance their business-wide and individual risk assessments.

123. Where competent authorities decide to provide subjects of assessment with a redacted version of their sectoral or sub-sectoral risk assessment, they should ensure this contains sufficient, and sufficiently meaningful, information to enable subjects of assessment to build this information into their own risk assessments.

##### **b. Guidance**

124. Competent authorities should issue guidance on the risk-based approach to subjects of assessment on what they expect subjects of assessment to do to comply with their AML/CFT obligations, using the ESAs' AML/CFT guidelines as a basis.

125. Competent authorities should also assess the need for further guidance in the sector. To do this, competent authorities should identify the level of AML/CFT knowledge and expertise in their sector, as well as reoccurring issues, emerging risks or other concerns arising from their analysis of information gathered for the risk assessment, findings from inspections, including thematic reviews, and from other engagements with the sector, including trade associations. Some of the indicators that may suggest that further guidance may be needed, include but are not limited to:

- a) Repeated failures by subjects of assessment to comply with certain AML/CFT obligations;
- b) changes in the legislative framework that may have an impact on the subjects' of assessment ability to comply with their AML/CFT obligations.
- c) evidence of de-risking in some sectors or subjects of assessment, or evidence that





- subjects of assessment avoid risks rather than manage ML/TF risks effectively;
- d) repeated requests for guidance on certain aspect of the AML/CFT framework;
  - e) changes in the legislative framework that may have an impact on the subjects' of assessment ability to comply with their AML/CFT obligations;
  - f) emergence of new risks and typologies.
126. Competent authorities should assess whether guidance may be needed for the sector as a whole or specific for a particular sub-sector or cover a specific topic. Competent authorities should ensure that guidance
- a) is clear and unambiguous;
  - b) facilitates and supports the implementation, by subjects of assessment, of an effective risk-based approach;
  - c) does not directly or indirectly foster or condone the indiscriminate de-risking of entire categories of customers.
127. Competent authorities should consider engaging with subjects of assessment and other relevant stakeholders when developing supervisory guidance. This may include, among other things, a public consultation process, engagement with trade associations, Financial Intelligence Units, law enforcement, other competent authorities or government agencies or through participation in consultative forums. Competent authorities should determine the most effective and adequate outreach for specific guidance. They should ensure that the outreach includes a sufficient proportion of stakeholders who will be impacted by the guidance and that sufficient time is allocated for stakeholders to communicate their views.
128. Competent authorities should periodically assess the adequacy of their existing guidance provided to the private sector. Such assessment should be done regularly or ad hoc, triggered by certain events, including changes in the national or European legislation, amendments to the national or supra national risk assessment or the feedback from the sector. Where, as a result of this assessment, competent authorities determine that guidance is no longer up to date, they should make and communicate the necessary amendments to it or, if determined that the guidance is no longer relevant, communicate this to the sector without undue delay.
- c. Communication with the sector**
129. Competent authorities should put in place and apply a communication strategy that ensures that their communications with subjects of assessment remain focused on improving AML/CFT compliance in certain sectors or the financial sector as a whole and to ensure the best use of their supervisory resources.
130. As part of their communication strategy, competent authorities should set out how they will communicate with different stakeholders, including when communicating the outcomes of their risk assessment and relevant guidance to the sector.



131. Competent authorities should identify the communication tools available to them and use the most effective tools when communicating with relevant stakeholders. These tools may include, but are not limited to:
- a) simultaneous communication with all subjects of assessment, which may include a publication on the competent authority's website; or posting on social media or through other online channels;
  - b) communication to a limited group of stakeholders, which may include the competent authority's participation at various conferences or training events or through an outreach to trade and professional associations;
  - c) communication through letters or circulars, which may be addressed to the sector as a whole or relevant groups of stakeholders; or
  - d) direct communication with subjects of assessment either on a bi-lateral or multilateral basis, including public consultations. Where the competent authority communicates bi-laterally, it should consider the relevance of this communication for a wider group of stakeholders, which may indicate that a potentially different communication tool may be more adequate.
132. When deciding on the most appropriate tools for communication, the competent authorities should consider at least the following elements:
- a) who is the target audience of the communication;
  - b) is the topic of the communication relevant for a particular group of stakeholders, a sector or the market as a whole;
  - c) the timing and urgency of the communication, ensuring that the required information is made available to subjects of assessment in a timely manner; and
  - d) the type of information that is being communicated.

#### **4.4.10 Training of competent authority's staff**

133. Competent authorities should ensure that staff with direct or indirect AML/CFT responsibilities have appropriate knowledge and understanding of the applicable legal and regulatory AML/CFT framework and are suitably qualified and trained to exercise sound judgement.
134. To ensure all relevant staff receive adequate training, competent authorities should develop a training program, which should be adjusted to meet the needs of specific functions within the competent authority, their job responsibilities, seniority and experience of staff. This training program should be kept up to date and reviewed regularly. Competent authorities should monitor the level of training completed by each individual or team as appropriate.
135. As part of this, competent authorities should ensure that their supervisors are trained in the practical application of their AML/CFT RBS model so that supervisors are able to carry out



risk-based AML/CFT supervision in an effective and consistent manner. Competent authorities should ensure that the outcomes of the sector-wide and individual ML/TF risk assessments are communicated to all relevant staff within the competent authority, including staff who are not directly involved in the risk-based AML/CFT supervision. Among other things, competent authorities should ensure that supervisors are able to:

- a) Understand the need for flexibility when a subject of assessment's view of risks and controls is different from the competent authority's view on the risk and take into consideration the argumentation provided by the subject of assessment;
- b) Assess the quality of a subject of assessment's risk assessment;
- c) Assess the adequacy, proportionality and effectiveness of the subject of assessment's AML/CFT policies and procedures and wider governance arrangements and internal controls in light of the subject of assessment's own risk assessment;
- d) Understand different products, services and financial instruments, and the risk attached to them;
- e) Understand the competent authority's supervisory framework, including the AML/CFT supervisory strategy and plan; and
- f) Understand supervisory tools used and practices put in place by the competent authority, and how they are relevant to the tasks carried out by the staff member, such as the use of supervisory tools, and the importance of cooperation with other stakeholders.

136. Training should be tailored to the AML/CFT responsibilities of relevant staff, and senior management, and may include internal and external training courses and conferences, e-learning courses, newsletters, case study discussions, recruitment, feedback on completed tasks and other forms of 'learning by doing'. Competent authorities may also benefit from knowledge sharing among competent authorities and with other relevant domestic and foreign authorities, such as prudential supervisors, the FIU, relevant EU bodies, other countries' AML/CFT supervisors.

137. Competent authorities should ensure that relevant training is provided in a timely manner especially for new staff and in case of significant changes within the AML/CFT supervisory framework. Competent authorities should ensure staff's AML/CFT expertise remains up to date and relevant, and includes awareness of emerging risks as appropriate.

## 4.5 Step 4 - Monitoring and updating of the RBS model

### 4.5.1 Review of the risk assessment and supervisory strategy and plans (Steps 1, 2 and 3)

138. The RBS is not a one-off exercise, but an ongoing and cyclical process. Therefore, competent authorities should carry out periodic or ad hoc reviews of the information on which their risk assessment is based, and update this information as necessary.



139. As part of the cyclical process, competent authorities should review and update their sectoral and individual risk assessments of subjects of assessment regularly through periodic reviews or on an ad-hoc basis.

140. Supervisory strategy and plans should also be updated as necessary, whether by establishing periodic reviews or as a response to external events. Supervisory strategy and plans should also reflect relevant changes to the risk assessments, in particular where emerging risks have been identified. Competent authorities should reflect the results of these reviews and updates as changes to the RBS.

**a. Periodic reviews**

141. Competent authorities should carry out periodic reviews of their individual and sectoral risk assessments to ensure that they remain up to date and relevant. As part of this, it is important that competent authorities verify that the underlying assumptions supporting the risk assessment are still up to date, including assumption related to the different level of risks posed by the relevant sectors and subjects of assessment or the understanding of the effectiveness associated with a certain supervisory tool.

142. The schedule of each review should be aligned with the supervisory strategy and commensurate with the ML/TF risk associated with the sector and the subject of assessment. For sectors and subjects of assessment that are exposed to significant or very significant ML/TF risks or those facing frequent changes in their activities and operating in a fast changing environment, reviews should take place more frequently.

**b. Ad hoc reviews**

143. Ad hoc reviews of the risk factors, the risk assessment and, where necessary, the supervisory strategy and plans should take place following significant changes affecting the subject of assessment's risk profile, including:

- a) Emerging ML/TF risks;
- b) Findings from off-site and on-site supervision and any follow-up of corrective or remedial actions taken by the subject of assessment;
- c) Changes to, or new information emerging in relation to, owners of qualifying holdings, members of the management board or key function holders operations or the organisation of the subject of assessment;
- d) the amendments to the European Commission's supra-national risk assessment published in accordance with Article 6(1) of Directive (EU) 2015/849, national risk assessment or the supervisory risk assessment developed in line with these guidelines;
- e) new type of firms entering the sector or sub-sector;
- f) sudden changes to the customer base within the sector or sub-sector;
- g) new information has emerged suggesting that the ML/TF risk exposure of in respect of a



specific subject of assessment or sector has increased;

- h) Other situations where the competent authority has grounds to believe that information on which it had based its risk assessment is no longer relevant or has significant shortcomings.

144. Competent authorities should also consider whether changes affecting one particular subject of assessment might affect other subjects of assessment, and they should also review the risk assessment of those subjects of assessment, which are significantly affected by the change.

145. Where, as a result of the amended risk assessment the risk categories or scores have changed, competent authorities should ensure that their internal systems and supervisory manual are updated accordingly.

#### **4.5.2 Review of the AML/CFT RBS model**

146. Competent authorities should seek to satisfy themselves that their internal processes and procedures, including their ML/TF risk assessment methodology, are up to date and are applied consistently and effectively. Competent authorities should review and update the methodology immediately, where necessary.

147. Where a review identifies issues with the AMF/CFT RBS model, competent authorities should take steps to address these. However, competent authorities should refrain from making repeated changes to their RBS model within short time intervals, to facilitate comparisons over time.

148. Where competent authorities use automated scoring systems to carry out their risk assessment, they should review the cases in which the automated score was amended on a basis of a professional judgement, which suggested that the allocated score did not accurately reflect the subject's of assessment risk profile. In such cases, competent authorities should examine whether the extent and frequency of such amendments may not be an indication of an error in the risk assessment methodology. If an error is identified, competent authorities should take the necessary steps to rectify it.

#### **a. Periodic reviews**

149. Competent authorities should periodically review whether their AML/CFT RBS model delivers the intended outcome and, in particular, whether the level of supervisory resources remains commensurate with the ML/TF risks identified. Competent authorities should use a variety of tools available to them when reviewing and assessing the adequacy and effectiveness of their AML/CFT RBS model. These tools include, but are not limited to:

- a) professional expertise;
- b) self-assessment questionnaires;
- c) sample testing of supervisory measures and actions,



- d) new information such as reports and feedback from other competent authorities or relevant AML/CFT authorities,
  - e) feedback from Financial Intelligence Units, law enforcement and other national agencies, or
  - f) publications by relevant European or international organisations.
150. Competent authorities should also seek to familiarise themselves with international best practices and consider participating in relevant international and European forums when possible.
151. Measuring the impact of AML/CFT supervision on the level of compliance and the effectiveness of subjects of assessments' AML/CFT controls may also help competent authorities assess the effectiveness of their AML/CFT RBS model.

#### b. Ad hoc reviews

152. In addition to regular reviews at fixed intervals, competent authorities should review, update or amend their AML/CFT RBS model if its adequacy or effectiveness is called into question by events such as:
- a) External evaluations of the model, including by the FATF, Moneyval or external audits;
  - b) Internal evaluations of the model, including an internal gap analysis, internal audit reports, quality assurance testing and 'lessons learned' exercises;
  - c) Significant changes of the legislative or regulatory AML/CFT environment;
  - d) Publication of relevant international guidance; and
  - e) Emergence or identification of new risk factors.

#### 4.5.3 Organisational and procedural aspects of the review process

153. Competent authorities should put in place an objective review process of their RBS model, which is based on clear and transparent internal procedures. Such procedures should at least set out:
- a) when the revision is due or what events would trigger the review;
  - b) what is the scope of the revision or how to determine the scope; and
  - c) who in the competent authority is in charge of the revision process. Competent authorities should consider whether the the team or person within the competent authority who was responsible for setting up the RBS model should also be responsible for the review of the model or whether a different person or team, such as the competent authority's internal quality assurance, internal audit or risk management team should be responsible for the review.



154. In addition to the internal review process, competent authorities should consider whether it is necessary to engage an external expert to obtain an objective evaluation of its RBS model or to ensure harmonisation on a national level with the models used by other competent authorities.

#### **4.5.4 Record keeping**

155. Competent authorities should document the AML/CFT RBS model, its implementation and subsequent reviews appropriately for its institutional (supervisory) memory and also to provide a record of outcomes and decisions and their underlying rationale to ensure that actions taken by competent authorities with regard to the different subjects of assessment are coherent and consistent.

#### **4.5.5 Accountability**

156. Senior management of the competent authorities should have an adequate understanding of the ML/TF risks present in the supervised sector and sub-sectors and be regularly informed on AML/CFT supervisory actions and their outcome. This is so they can judge the overall effectiveness of the measures implemented by the subjects of assessment to reduce these risks as well as the need to review, where appropriate, the intensity and frequency of the supervision and the allocation of supervisory resources.

157. Adequate governance arrangements should be put in place by competent authorities for approval of the supervisory strategy at a senior management level and any amendments thereafter. Senior management should also ensure that the AML/CFT supervisory strategy is implemented within the competent authority. In particular, they should ensure that the competent authority has sufficient AML/CFT specialist, legal, policy and risk specialist resources to implement the strategy.

# Annex

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## Conversion of risk categories

**Scenario 1:** Where a competent authorities are categorising its subjects of assessment and sectors within three risk categories, they should apply the approach set out in Table 1 when asked to convert the risk categories into four categories as suggested by these guidelines.

<i>Competent authority's risk categories</i>	<i>Risk categories suggested in these guidelines</i>
<i>Low risk</i> →	Less significant risk
<i>Med risk</i> →	Moderately significant risk
<i>High risk</i> →	Very significant risk

**Scenario 2:** : Where competent authorities are categorising their subjects of assessment and sectors in five risk categories, they should apply the approach set out in Table 2 when asked to convert the risk categories into four categories as suggested by these guidelines.

<i>Competent authority's risk categories</i>	<i>Risk categories suggested in these guidelines</i>
<i>Low risk</i> →	Less significant risk
<i>Medium low risk</i> →	Less significant risk
<i>Med high risk</i> →	Moderately significant risk
<i>High risk</i> →	Significant risk
<i>Ultra/very high risk</i> →	Very significant risk



## 5. Accompanying documents

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### 5.1 Draft cost-benefit analysis / impact assessment

#### A. Problem identification

1. Directive (EU) 2015/849, in line with international standards in combating money laundering and the financing of terrorism developed by FATF, puts the risk-based approach at the centre of EU's AML/CFT regime. For firms, the risk-based approach is the basis of the application of a proper risk-management system. For competent authorities, risk-based approach serves to identify, understand and mitigate ML/TF risks and, based on the understanding of ML/TF risks to which sectors and firms are exposed, adjust resources accordingly in order to exercise risk-based approach to AML/CFT supervision.
2. The legal basis for the application of risk-based approach to AML/CFT supervision is set out in Article 48(6) of Directive (EU) 2015/849, which requires competent authorities, when carrying out risk-based supervision to have a clear understanding of ML/TF risks in their jurisdiction, access to relevant information through both on-site and off-site supervisory activities and to adjust intensity and frequency of their risk-based supervision in line with the level of ML/TF risk presented by firms under their supervision. These requirements were complemented by the mandate given to the EBA under Article 48 (10)<sup>14</sup> of Directive (EU) 2015/ 849 to issue guidelines containing the characteristics of a risk-based approach and the steps to conduct risk-based supervision. EBA, together with EIOPA and ESMA, published these guidelines on 16 November 2016.
3. In addition, Directive (EU) 2018/843, was published on 19 June 2018 and had to be transposed by the Member States by 10 January 2020. Directive (EU) 2018/843 amended Directive (EU) 2015/849 and further strengthened the AML/CFT supervisory framework by including specific requirement for competent authorities to cooperate and exchange information between themselves and with other supervisors, including prudential supervisors and supervisors from third country authorities. On this basis, the EBA, together with EIOPA and ESMA, published

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<sup>14</sup> Art. 48(10) of Directive (EU) 2015/849: By 26 June 2017, the ESAs shall issue guidelines addressed to competent authorities in accordance with Article 16 of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010 on **the characteristics of a risk-based approach to supervision** and the steps to be taken when **conducting supervision on a risk-based basis**. Specific account shall be taken of the nature and size of the business, and, where appropriate and proportionate, specific measures shall be laid down.



guidelines<sup>15</sup> that establish a framework and set out practical modalities for this cooperation to happen in AML/CFT supervisory colleges.

4. Directive (EU) 2019/2177 amended Directive (EU) 2015/849 of 18 December 2019 and in particular Article 48(10) of Directive (EU) 2015/849. Thereafter guidelines on the characteristics of a risk-based approach to supervision and the steps to be taken when conducting supervision on a risk-based basis shall be issued in accordance with Article 16 of Regulation (EU) No 1093/2010 and shall be issued by the EBA from 1 January 2020.

## B. Policy objectives

5. In the first version of the guidelines, the ESAs built on the high-level principles of risk-based supervision set out in Directive (EU) 2015/849 and explained the steps that supervisors should take to implement it in practice. However, the European Commission concluded in its post-mortem report of July 2019 that competent authorities found the application of the risk based approach in practice challenging. The commission also concluded that the lack of cooperation between competent authorities had contributed to some of the issues raised in the report. In addition, mutual evaluations carried out by international bodies like FATF and IMF have also highlighted weaknesses in the supervisory approaches in a number of EU Member States. Moreover, the EBA's report on the competent authorities' approaches to AML/CFT supervision of banks published in February 2020 concluded that more detailed guidance may be needed in some areas of supervision to ensure that competent authorities are well equipped to identify and assess ML/TF risks that firms under their supervision are exposed to and that they take robust supervisory actions when they identify weaknesses in the firms' AML/CFT frameworks. Other EBA reports, such as the cum-ex report<sup>16</sup>, pointed out that the guidelines need to strengthen the cooperation between AML/CFT supervisors and tax authorities.
6. To that end, the main objective of the revised guidelines is to develop further the concept of risk-based approach to AML/CFT supervision in order to achieve greater harmonization of supervisory practices across the EU, while being mindful that competent authorities are at different maturity levels in the development of their supervisory approaches. To that end, the revised guidelines aim to clarify further what supervisors are required to do to identify and assess ML/TF risks associated with firms under their supervision by making a distinction between sector-wide and individual risk factors. To achieve this, the guidelines now elaborate further on the sources and type of information that supervisors need to obtain to carry out the risk assessment by placing specific emphasis on the information gathered through cooperation and the information gathered directly from the firms.

<sup>15</sup>Joint guidelines on cooperation and information exchange for the purpose of Directive (EU) 2015/849 between competent authorities supervising credit and financial institutions (JC 2019 81); Available at: [https://eba.europa.eu/sites/default/documents/files/document\\_library/Joint%20Guidelines%20on%20cooperation%20and%20information%20exchange%20on%20AML%20-%20CFT.pdf](https://eba.europa.eu/sites/default/documents/files/document_library/Joint%20Guidelines%20on%20cooperation%20and%20information%20exchange%20on%20AML%20-%20CFT.pdf)

<sup>16</sup> EBA Report on competent authorities' approaches to tackling market integrity risks associated with dividend arbitrage trading schemes (EBA/REP/2020/15); available at: <https://eba.europa.eu/eba-publishes-its-inquiry-dividend-arbitrage-trading-schemes-%E2%80%9Ccum-excum-cum%E2%80%9D-and-announces-10-point>



7. In addition, the guidelines provide additional guidance and explanations how supervisors should use their risk assessment when developing their supervisory strategy and plans and how they should choose their supervisory tools to ensure that are commensurate with the risk that the firm is exposed to.
8. Regarding the greater harmonization in the process of identifying and understanding ML/TF risks, the guidelines aim at introducing common ML/TF risk categories (i.e. less significance, moderately significant, significant and very significant). These proposed ML/TF risk categories are aligned with the methodology of the supranational risk assessment report published by the Commission on July 2019<sup>17</sup>. The amended guidelines also leverage on recently developed regulatory instruments, such as the EBA's Risk Factors Guidelines<sup>18</sup>, AML/CFT colleges guidelines<sup>19</sup>, the EBA's cooperation guidelines under Art. 117 of Directive 2013/36/EU, which are currently being developed, draft regulatory technical standards (RTS), which are currently being developed by the EBA under Article 9a of Regulation (EU) No 1093/2010 and the amended guidelines on internal governance under Directive 2013/36/EU. Moreover, the guidelines aim to be aligned to international standards (e.g. FATF risk-based approach guidance, BCBS guidelines on interaction and cooperation between prudential and AML/CFT supervision, etc.).
9. Generally, the enhanced detail and the greater harmonisation would help competent authorities to operationalise the risk-based approach to AML/CFT supervision, strengthening the level playing field for AML/CFT supervision in the single market.

### C. Baseline scenario

10. The ESA's Guidelines on risk-based AML/CFT supervision, published in November 2016 with effective date of implementation by one year after the publication, aimed at ensuring that supervisors take certain steps when implementing their risk-based supervision model.
11. Afterwards, the EBA's report on the competent authorities' approaches to AML/CFT supervision of banks published in February 2020 identified weaknesses in the application of risk-based approach to AML/CFT supervision. In particular, the report contained recommendations on how competent authorities can address the issues identified in the report and included, among others, recommendations related to the sectoral and sub-sectoral risk assessments, supervisory strategy and plan and supervisory cooperation.

<sup>17</sup> The supranational risk assessment report is issued under the mandate conferred by Article 6(1) of AMLD4 to update its report every two years.

<sup>18</sup> Consultation Paper on the draft guidelines under Articles 17 and 18(4) of Directive (EU) 2015/849 on customer due diligence and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions (JC 2019 87)

<sup>19</sup> Joint guidelines on cooperation and information exchange for the purpose of Directive (EU) 2015/849 between competent authorities supervising credit and financial institutions (JC 2019 81); Available at: [https://eba.europa.eu/sites/default/documents/files/document\\_library//Joint%20Guidelines%20on%20cooperation%20and%20information%20exchange%20on%20AML%20-%20CFT.pdf](https://eba.europa.eu/sites/default/documents/files/document_library//Joint%20Guidelines%20on%20cooperation%20and%20information%20exchange%20on%20AML%20-%20CFT.pdf)



12. In order to mitigate the identified weaknesses, the review of the Risk-based Supervision Guidelines will mainly strengthen areas related to cooperation with other competent authorities, risk assessments, supervisory strategy and plan, supervisory tools including follow up, guidance to the sector and training.

#### D. Options considered

13. The EBA considered whether the review of the existing guidelines should be tackled through an update or a complete overhaul, and whether the level of detail should be maintained as high level guidelines with some elements of specific guidance or detailed guidelines with specific examples.

#### Approach

##### Option 1: Minor changes to the GLs are introduced

14. These guidelines could adopt the same approach as the original Risk-Based Supervision Guidelines<sup>20</sup> with only minor updates and clarifications included where necessary. The first version of the guidelines was developed to fulfil the mandate of Article 48(10) of Directive (EU) 2015/849 to create a common understanding of the risk-based approach to AML/CFT supervision by explaining the characteristics and the steps of risk-based supervision. This option would be the least disruptive to the competent authorities who have already put in place their risk-based supervision models but would be ineffective to address the weaknesses identified in supranational reports and the report published by the EBA summarising findings from the implementation reviews.

##### Option 2: Substantial changes of the guidelines

15. Substantial changes are included by introducing subsections within already existing parts of the guidelines in those areas where weaknesses were identified (cooperation and information exchange, sources and types of information required for the risk assessment and sectoral, sub-sectoral, group and individual risk assessments) and by including new sections to the whole structure of the guidelines (supervisory tools, supervisory practices and supervisory follow-up).
16. The Commission in the supranational risk assessment report issued in July 2020 pointed out that the European Banking Authority, pursuant to the Council Action Plan, works on more detailed guidance for the application of the relevant rules. This additional sections will provide more detail to supervisors when performing risk-based approach to AML/CFT supervision and provide more clarity to the existing provisions to avoid breaches of the AML/CFT regime.

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<sup>20</sup> Joint Guidelines on the characteristics of a risk-based approach to anti-money laundering and terrorist financing supervision, and the steps to be taken when conducting supervision on a risk-sensitive basis.



### Option 3: Not to amend the guidelines

17. The EBA implementation review published in February 2020<sup>21</sup> raised the need of reviewing the guidelines in those areas where weaknesses were identified. Therefore, this option would not be desirable in line with the Commission supranational risk assessment report and the EBA implementation reviews.

### Option 4: Draft a completely new set of the guidelines

18. A complete review of the guidelines would increase the risk of misalignment of the guidelines to the international standards and FATF recommendation 26 and its interpretative note. Moreover, a complete overhaul could be too disruptive approach for competent authorities who have already implemented their risk based approach in line with the existing guidelines.

### Level of detail

#### Option 1: High level guidelines with some elements of specific guidance

19. This is the approach of the first version of the Risk Based Supervision Guidelines, that provide high-level principles, which are complemented with detail in some areas. This approach would represent continuity with respect to the previous guidelines, but would not effectively address weaknesses identified in the implementation reviews carried out by the EBA. In order strengthen supervisory convergence in the area of AML/CFT supervisions, it is therefore desirable that the guidelines are a bit more detailed than the level 1 text in respect of some areas.
20. However, taking into account that the Directive (EU) 2015/849 is a minimum harmonisation directive that requires the Member States to transpose it in their national legislation allowing the Member States to impose additional requirements where they are justified on a basis of an increased ML/TF risk only a certain level of harmonisation can be achieved through guidelines.
21. This option gives more flexibility to competent authorities to adapt the guidelines to the specific characteristics of different sectors and risks, but it will not contribute towards the harmonisation of specific aspects of the risk-based supervision approach.

#### Option 2: Guidelines with enhanced level of detail

22. The updated guidelines will provide further details to the previously existing sections and include new sections in those areas with needs of further enhancement. This approach will increase guidance to competent authorities on those areas where weaknesses have been

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<sup>21</sup> EBA report on competent authorities' approaches to the anti-money laundering and countering the financing of terrorism supervision of banks, EBA/Rep/2020/06.



identified and those that would need alignment with other regulatory products recently developed (e.g. cooperation and information exchange), without representing a complete overhaul of all subsections of the guidelines. Moreover, these guidelines should be sufficiently flexible so that they can be applied by AML/CFT supervisors in all sectors<sup>22</sup>. Thus, supervisors should be able to apply these guidelines equally when supervising sectors that are exposed to less significant and very significant ML/TF risks, which may not be possible if the guidelines are too detailed or too prescriptive.

23. These additional details would not constraint competent authorities in the process of adapting the supervisory approach to the risk identified in the local markets and across different sectors, but facilitate the work through the additional clarity about the supervisory tools and powers available for them to fulfil an effective risk-based AML/CFT supervision.

#### E. Preferred option

24. Option 2 is the preferred option.

#### F. Cost-benefit analysis

25. The implementation of the amended guidelines, which further develop pre-existing provisions and add new ones, entails one-off costs for competent authorities and firms and future costs associated with the evolving adaptation of supervisory practices to the level of ML/TF risk associated with a sector, a particular product or a group of clients.
26. Regarding AML/CFT supervisors, one-off costs are related to carrying out sectoral and sub-sectoral risk assessment, if not done so already, the adaptation of methodologies, supervisory manuals, policies and procedures, and the implementation of the necessary cooperation mechanisms where they do not exist. Moreover, staff should be trained in order to ensure a consistent application of the supervisory tools and practices in line with the supervisory manual. Other future costs are related to the update of the supervisory practices to the evolving conditions of the market and sectors of activity (e.g. increased risk identified in a sector is accompanied by a more intensive and intrusive supervisory tools).
27. According to the EBA implementation report published in February 2020, all competent authorities assessed had implemented the risk-based approach to AML/CFT supervision at different levels of maturity. Thus the additional costs of the implementation of the amended risk-based supervision guidelines is expected to be medium.
28. Benefits for AML/CFT supervisors, after developing effective supervisory strategy and plans, they will be able to adjust their resource and supervisory efforts in a more efficient manner by allocating more resources to the supervision of those sectors that are exposed to more significant ML/TF risks. This means that for less risky sectors supervisors will be able to choose supervisory tools that are less resource intensive, while not sacrificing the effectiveness of their

<sup>22</sup> Credit institution or a financial institution as defined in Article 3(1) and (2) of Directive (EU) 2015/849.



supervision. The new guidelines will also ensure the application of common supervisory practices and harmonisation of certain terms, will make it easier for the competent authorities to cooperate and exchange information with other competent authorities and other stakeholders. Moreover, increased convergence and better understanding of supervisory practices will make it easier for the comment authorities to adjust their practices in future when they will be required to report certain information to the EBA through the database which is currently being created in line with Article 9a of Regulation (EU) No 1093/2010.

29. In a long run, the implementation of these guidelines would potentially lead to more clarity within the market of the supervisory expectations, which could lead to less breaches and shortcomings committed by firms. As a consequence, it would reduce the supervisory measures and sanctions that supervisors should impose and, instead, their focus will be more on more effective supervision of more risky firms and sectors and less efforts will be required for the supervisory follow up actions.

#### G. Overall impact assessment

30. For the purposes of assessing the level of implementation of the guidelines, we leverage on data provided by competent authorities (CAs) during 2020 for the purposes of the bi-annual Joint Opinion on ML/TF risks affecting the European Union's financial sector published by the EBA under Article 6(5) of Directive (EU) 2015/849.
31. Regarding the policy objective of fulfilling greater harmonization in the risk assessment process through the use of four ML/TF risk categories<sup>23</sup>, less than half of the competent authorities use different risk categorization. Therefore, the impact of implementing the harmonized risk categories is low, considering the fact that the CAs that use national categorization already have implemented systems to allocate firms within different risk categories.
32. Regarding the methodology for risk assessment, most competent authorities account with formal risk assessment methodology such as that envisaged in the previous version of the guidelines, in particular for some sectors (e.g. credit institutions, life insurance undertakings, payment institutions and investment firms). Thus, the impact of implementing the additional provisions of risk assessment from an ML/TF perspective (i.e. relating to sectoral and sub-sectoral risk assessment) is expected to be low.
33. After the implementation of a robust supervisory strategy which is based on competent authorities' risk assessment, those competent authorities that have so far mainly focused on the supervision of banks will need to make adjustments in their supervisory approach to ensure that they also focus on other firms or sectors presenting significant or very significant risk. Equally, those competent authorities that applied no supervision to sectors presenting less significant risk, will also need to adjust their approach to ensure that all subjects of assessment or sectors receive adequate supervision in line with their risk exposure. This means that, in line with the risk based approach, sectors or subjects of assessment that are less vulnerable to ML/TF may receive less intense or less frequent supervision than the sectors or subjects of

<sup>23</sup> Less significant, moderately significant, significant and very significant.



assessment that are exposed to more significant levels of ML/TF risk. Thus, the impact of implementing risk-based supervisory tools and practices of the new guidelines is expected to be medium.

## 5.2 Overview of questions for consultation

1. Do you have any comments with the proposed changes to the 'Subject matter, scope and definitions'?
2. Do you have any comments with the proposed changes to the Guideline 4.1 'Implementing the RBS model'?
3. Do you have any comments on the proposed changes to the Guideline 4.2 'Step 1- Identification of risk and mitigating factors'?
4. Do you have any comments on the proposed changes to the Guideline 4.3 'Step 2 – Risk assessment'?
5. Do you have any comments with the proposed changes to the Guideline 4.4 'Step 3 - Supervision'?
6. Do you have any comments on the proposed changes to the Guideline 4.5 'Step 4 – Monitoring and updating of the RBS model'?