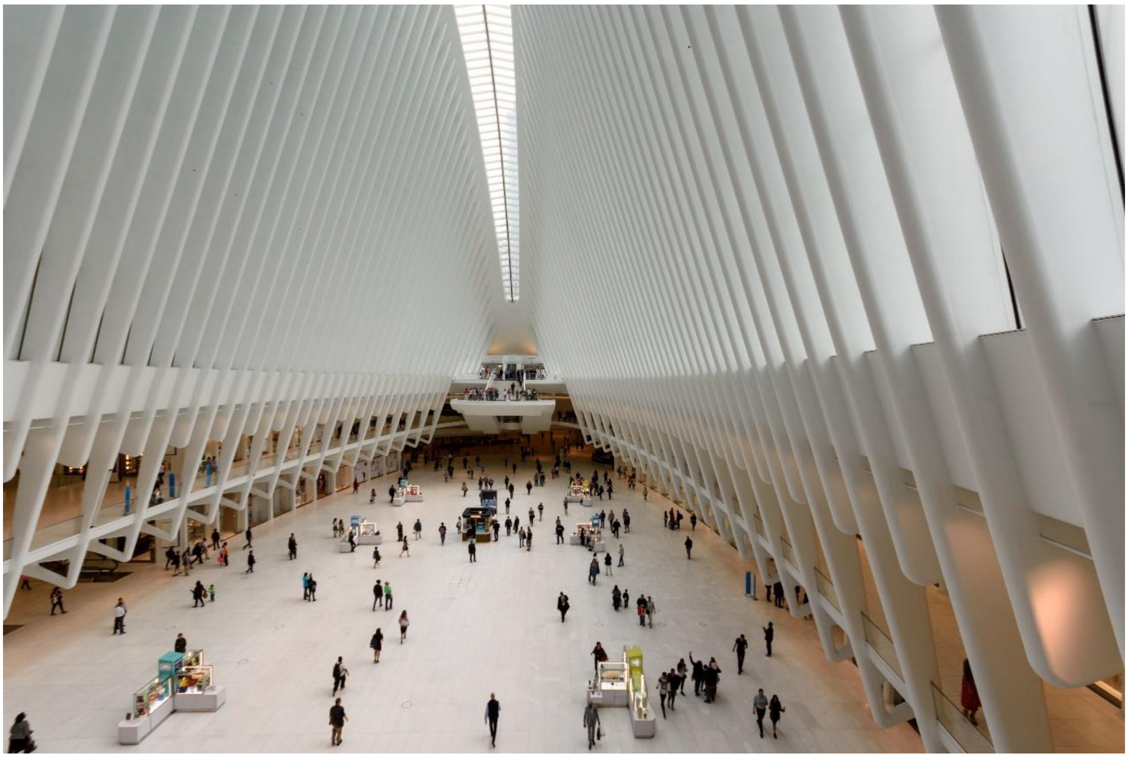
A Risk-Based Approach in a Post COVID-19 World. Is it Still Relevant?



How a risk-based approach is still a relevant concept in Financial Crime control as we move into the new normal COVID-19 world

23 February 2021 – Andrew O'Connor

Much has been written about the adoption of risk-based approaches to anti-money laundering ("**AML**"), counter-financing of terrorism ("**CFT**") and financial crime controls by financial institutions. However, the COVID-19 pandemic has had a major impact on our lives and the way we will live and work going forward. This poses unprecedented challenges to the normal operations of the banks and financial institutions, and notably the client due diligence processes. For example, using digital verification platforms rather than in-person verification is considered a potentially higher risk scenario for AML/CFT.[1] But in-person verification is not viable due to health risks. Obtaining certified true copies is nearly impossible due to the lack of in-person verifications. Meanwhile, telecommuting from home means physical documents do not get sent and or received in a timely manner as required by regulators.

To overcome some of the difficulties imposed by the COVID-19 pandemic, some regulators in the APAC region have released guidance and measures to meet Know Your Customer ("**KYC**") requirements as we transition through COVID-19. For example:

1. The Monetary Authority of Singapore ("**MAS**") issued a circular on 23 March 2020, to provide an advisory on implementing safe distancing measures to combat COVID-19. These measures included encouraging both individual and corporate customers to use online or mobile platforms for financial transactions and replacing face-to-face meetings with video-conferences or teleconferences.[2]

2. The Hong Kong Monetary Authority ("**HKMA**") issued a circular relating to Coronavirus

[1] See Interpretive Note to Recommendation 10 of the Financial Action Task Force Recommendations - https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf
[2] See https://www.mas.gov.sg/news/media-releases/2020/mas-tells-financial-institutions-to-adopt-safe-distancing-measures

(COVID-19) and AML/CFT measures on 7 April 2020.[3] The HKMA reinforced the importance of applying the principles of the risk-based approach in resource allocation, maintaining adequate records of decisions made and that relevant controls or risk appetite need not be compromised in the process.

3. The Australian Transaction Reports and Analysis Centre ("**AUSTRAC**") issued guidance on how to comply with KYC requirements during COVID-19 and providing alternatives to the required identity documents.[4]

4. The Reserve Bank of India ("**RBI**") issued a circular on 16 March 2020, to provide instructions on operational and business continuity guidelines during COVID-19. On 1 April 2020, the RBI instructed all banks to ensure uninterrupted operations of small accounts (accounts opened for financial inclusion under the Prime Minister's order) between April and June 2020, even though such accounts would otherwise be blocked due to failure to complete KYC measures. The Securities Exchange Board of India ("**SEBI**") provided deferral of submission of physical certified documents from Foreign Portfolio Investors until 30 June 2020.[5]

As COVID-19 accelerates the changes to how we live and work, it is also creating new opportunities for financial crime, including via cryptocurrencies and decentralised financial services platforms. In late 2020, the United States Justice Department and the Commodities Futures Trade Commission ("CFTC") hammered a cryptocurrency exchange, BitMEx, and its principals with a coordinated criminal and civil prosecution, including charges of failing to implement and maintain and adequate AML program. The Financial Action Task Force has noted that certain characteristics of virtual currencies, coupled with their global reach, present potential AML/CFT risks such as:

- the anonymity provided by the trave in virtual currencies on the internet;
- the limited identification and verification of participants;
- the lack of clarity regarding the responsibility for AML/CFT compliance, supervision and enforcement for these transactions that are segmented across several countries; and
- the lack of a central oversight body.[6]

With cryptocurrency prices surging in recent months, the significance of cryptocurrency risks increases, including risks relating to cyber security breaches and an increase in scams.

The responsibility for combatting financial crime remains with banks and financial institutions, and critically this includes adjusting policies and processes to modernize an effective risk-based approach to KYC in an ever-changing environment. A risk-based approach enables banks and financial institutions to review and qualify the risks identified, critically allowing resources to be targeted on the real risks posed instead of a generic tick box assessment where the real risk exposed may inadvertently be missed. While banks and financial institutions have existing governance frameworks detailing policies and processes for AML/CFT, these policies and processes need acclimatizing to manage the dynamic changes in the operating environment that COVID-19 is accelerating. The immediate, high-level changes in client due diligence facing banks and financial institutions are illustrated below:

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[3] See HKMA, "Coronavirus disease (COVID-19) and Anti-Money Laundering and Counter-Financing of Terrorism measures – An Update" 30 July 2020, https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2020/20200730e1.pdf

[4] See AUSTRAC, "How to comply with KYC requirements during the COVID-19 pandemic", April 1 2020, https://www.austrac.gov.au/business/how-comply-and-report-guidance-and-resources/customer-identification-and-verification/kyc-requirements-covid-19

[5] See "SEBI eases processing of FPI documents in lockdown-hit areas", 31 Aug 2020, https://economictimes.indiatimes.com/markets/stocks/news/sebi-eases-processing-of-fpi-documents-in-lockdown-hit-areas/articleshow/77854900.cms?from=mdr

[6] See https://www.fatf-gafi.org/documents/documents/virtual-currency-definitions-aml-cft-risk.html

Risk management challenges during COVID-19		
Face to Face Meetings	**Certified True Copies**	**Documentation**
Leverage digital platforms to replace tradition face to face requirements	Allow soft copy verification whilst pending certified true copies or originals	Increase in timeline to receive pending KYC documentation before account blocking

A risk-based approach as a concept remains relevant, more so in a post COVID-19 world. Risks will change with the environment, and this often means a change in client behaviours, including actions which normally would not be considered suspicious that now emanate a red flag in KYC assessments. In other words: what banks and financial institutions know about their clients might well not be up-to-date anymore.

To combat such evolving financial crime risks, the evolution of the risk-based approach framework is vital. In today's accelerated digital world, the typical 1, 2 or 3 years refresh cycle is no longer an optimum approach and adversely impacts the monitoring of customers with outdated information. Banks need to look towards a perpetual KYC based on near real-time trigger events to keep customer risk profiles updated. The integration of AI solutions (e.g. ongoing adverse news solutions) would form best practice going forward.

Importantly, it will relieve the pressures on overburdened AML/CFT resources employed on areas that have increased value from a financial crime control outlook. Financial institutions and banks must upgrade their capabilities to allow a perpetual review based on near real-time trigger events and ensure they review their risk-based approach frameworks sufficiently, ensuring that their prioritisation of key risks and controls are in line with the new COVID-19 world and beyond.

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