ST. KITTS BRANCH Financial Services Regulatory Commission

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KYC RISK ASSESSMENT

KNOWING YOUR RISK EXPOSURE

It is essential for Regulated Entities to be able to identify the money laundering (and associated legal, regulatory and reputational) risks facing its business, given its customers and products and service profile. Conducting risk assessments on customers allows the Regulated Entity to identify, assess and understand the money laundering (ML) and terrorist financing (TF) risks associated with each customer. Once these risks are properly understood, entities can apply AML/CFT measures that correspond to the level of risk: a risk-based approach (RBA).

The Financial Action Task Force (FATF) Recommendations explicitly envisage that Financial Institutions will take a risk-based approach to AML/CFT. The risk-based approach enables Regulated Entities to prioritize their resources and allocate them efficiently.

CUSTOMER DUE DILIGENCE

Customer Due Diligence (CDD) comprises information about a client that enables an entity to assess the extent to which that client exposes it to a range of risks, including the risk of involvement in money laundering/terrorist financing.

CDD is often referred to as KYC (Know Your Customer) information. However, CDD is a far more holistic concept than the basic client identification measures, and encompasses a wide range of information and processes, which need to be gathered, verified and assessed throughout the business relationship.

CDD information generally comprises of the following aspects:

* Who is the client?
* What are the geographical locations of the client's residential address, and business interests?
* What is the nature of the client's business interests/occupation?
* What is the commercial rationale for the relationship between the client and the organization (what is the client seeking to achieve)?
* What is the client's source of funds/wealth?
* What has been the historical pattern of the client's relationship activity with the business, and has it been consistent with what was expected at the outset of the business relationship?
* Is the current or proposed activity consistent with the client's profile?

IDENTIFYING CUSTOMER TYPES

The customer type determines the parameters for KYC risk assessment. Customer types may be defined and distinguished simply as individuals and businesses. More specific definitions may include international individual, domestic individual, partnership, international corporation, domestic corporation, trust, correspondent bank, foreign banking institution, money service business, cash-intensive business, non-bank financial institutions (NBFIs), etc.

Classifying customers with a particular customer type helps with the identification of customers conventionally associated with a heightened risk for money laundering/terrorist financing exposure, such as cash intensive businesses and Politically Exposed Persons (PEPs). For example, the risks posed by an ordinary retail bank current account for a local resident earning $40,000 per annum with an obvious source of funds and regular standing order or direct debit expenditure will not be as great as the risks of a relationship with a foreign PEP wishing to invest $1 million through an offshore trust in a company based in a high risk jurisdiction. The amount of CDD information required in the latter part of the example, both at the outset and throughout the duration of the relationship, will be far greater, in order for the bank to be able to assess and monitor the risk.

Topics Discussed:

KYC RISK ASSESSMENT PROCESS

To effectively assess the risk associated with a customer, the following steps should be conducted:

1. Identification of Customers— this includes the collection of identification documents, such as valid Government-issued IDs and proof of address verification documents. *(See the FSRC's February 2016 Newsletter for information on the acceptable forms of proof of address verification)* The documents collected should be used to gather basic information on the customer such as his/her address, date of birth and full name.

2. Conducting Customer Due Diligence Checks — software and search engines such as Google, World-Check, Interpol and World Compliance can be used to verify whether the client has been listed on any Watch/ Sanction List or whether the customer has been involved in any illegal activities that will reflect badly on the reputation of the Entity if a business relationship with the customer is established. The objective is to gather any information on the customer which will affect the level of risk posed by him/her.

3. Carrying out the customer risk assessment — After collecting the relevant customer information and performing the due diligence checks, the customer's risk assessment should be conducted using the information gathered. Some Entities may have a software in place to automatically assess the risk posed by their customers based on the information inputted into the system, while other entities manually assess the risk posed by their customers using a risk rating matrix. The risk associated with a customer should be assessed by considering factors such as the customer's geographical origin, the customer type, occupation and source of wealth. *(See the FSRC's January 2015 Newsletter for more information on the factors to be considered in a risk assessment)*

CLASSIFICATION OF RISK

Assessing the ML/TF risks associated with a customer means that the Financial Institution has to determine how the ML/TF threats identified will affect it. The information obtained should be analyzed to understand the likelihood of these risks occurring, and the impact that these would have on the institution, and possibly on the national economy if they did occur.

The risk associated with a customer is often classified as low, medium or high, with possible combinations between the different categories (medium-high; medium-low, etc.). This classification is meant to assist in understanding ML/TF risks associated with various customers and to help prioritize them. Assessing ML/TF risks therefore goes beyond the mere collection of quantitative and qualitative information: it forms the basis for effective ML/TF risk mitigation and should be kept up-to-date to remain relevant.

WHEN SHOULD CUSTOMER RISK ASSESSMENTS BE PERFORMED

Risk Assessments should be conducted on both new and existing customers.

In the case of new customers, a risk assessment should first be performed before the business relationship is accepted. The results of the risk assessment should facilitate the decision on whether the customer's business will be accepted.

In a case where a risk assessment was not performed on an existing customer for any particular reason such as, the FI did not have an established risk assessment model in place at the time the business relationship with the customer was created, efforts should be made to obtain the relevant customer information required for the completion of the risk assessment in a timely manner.

Review of Customer Risk Assessments

KYC is a continuous process of monitoring the customer. Therefore, KYC Risk Assessments should be on-going, as customer information often changes. The following ensure the ongoing assessments of customers and their behavior:

1. Periodic Review — Based on the customer's risk score, the institution should have a system in place to determine the next review date. If the customer poses high risk to the FI, then the customer will be reviewed more often compared to medium or low risk customers.

2. Accelerated Review — This review considers changes in customers' information or their behavioral pattern. If there is a change in any aspect that will affect the results of the initial risk assessments such as the frequency of transactions or a change in country of residence, then a review of the risk assessment should be performed.

KYC Risk Assessment is a vital component for an effective and strong AML/CFT regime.

KNOW YOUR CUSTOMERS AND THEIR ASSOCIATED RISKS!

References:

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- *Anti-Terrorism (Prevention of Terrorist Financing) Regulations (ATR), No. 47 of 2011.*
- *Anti-Money Laundering Regulations (AMLR), No. 46 of 2011.*
- *The FATF Recommendations (2012)*

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