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Joint Consultation Paper

Joint Guidelines under Article 48 (10) of Directive (EU) 2015/849 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

The Risk-Based Supervision Guidelines

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1. Responding to this Consultation

The European Supervisory Authorities (the ESAs) invite 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 ESAs should consider.

Submission of responses

To submit your comments, click on the ‘send your comments’ button on the consultation page by 22 January 2016. 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 ESAs’ 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 ESAs’ Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the ESAs is based on Regulation (EC) N° 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the ESAs in their implementing rules adopted by their Management Boards. Further information on data protection can be found under the Legal notice section of the ESAs’ website.

2. Executive Summary

Directive (EU) 2015/849 of the European Parliament and 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 aims, *inter alia*, to bring European legislation in line with the Financial Action Task Force's International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation. It puts the risk-based approach at the centre of Europe's anti-money laundering and countering the financing of terrorism (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.

Article 48 (10) of Directive (EU) 2015/849 requires the ESAs to issue guidelines to competent authorities on the characteristics of a risk-based approach to AML/CTF supervision (RBS) and the steps supervisors should take when conducting AML/CFT supervision on a risk-sensitive basis. The aim is to create both a common understanding of the RBS and to establish consistent and effective supervisory practices across the EU. The ESAs are required to take specific account of the nature and size of a business and lay down specific measures where this is appropriate and proportionate.

In these guidelines, the RBS is characterised as an on-going and cyclical process that includes four steps:

- the identification of ML/TF risk factors, whereby competent authorities obtain information on both domestic and foreign ML/TF threats affecting the relevant markets;
- the risk assessment, whereby competent authorities use this information to obtain a holistic view of the ML/TF risk associated with each credit or financial institution ('firm'), or group of firms, including the inherent risk to which the firm or group of firms is exposed and the risk mitigants a firm or group of firm has in place;
- the allocation of AML/CFT supervisory resource based on this risk assessment, which includes decisions about the focus, depth, duration and frequency of on-site and off-site activities, and supervisory staffing needs, including technical expertise ; and
- monitoring and review to ensure the risk assessment and associated allocation of supervisory resource remains up to date and relevant.

These guidelines make recommendations for each of these four steps.

These guidelines aim to provide a common European basis for compliance with the FATF's recommendations on risk-based AML/CFT supervision and build the ESAs' 'Preliminary report on

anti-money laundering and counter financing of terrorism Risk Based Supervision', which was published in October 2013.^[1]

¹ Joint Committee of the European Supervisory Authorities : "Preliminary report on anti-money laundering and counter financing of terrorism Risk Based Supervision", JC-2013-72, October 2013
<http://www.eba.europa.eu/documents/10180/16145/JC-2013-72+%28Report+on+Risk+Based+Supervision%29.pdf>
<https://eiopa.europa.eu/joint-committee/index.html>
<http://www.esma.europa.eu/content/Preliminary-report-anti-money-laundering-and-counter-financing-terrorism-Risk-Based-Supervis>

3. Background and rationale

On 26 June 2015 Directive (EU) 2015/849 of the European Parliament and 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 entered into force. This Directive aims, *inter alia*, to bring European 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 anti-money laundering standard setter, adopted in 2012.

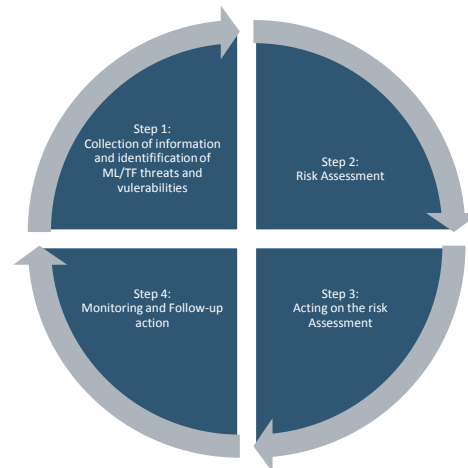
In line with the FATF's standards, the Directive puts the risk-based approach at the centre of Europe's anti-money laundering and countering the financing of terrorism (AML/CFT) regime. It recognises that the risk of money laundering (ML) and terrorist financing (TF) can vary and that Member States, 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 can allocate their AML/CFT supervisory resources to areas of higher ML/TF risk and exercise their responsibilities more effectively.

Article 48 (10) of Directive (EU) 2015/849 requires the ESAs to issue guidelines to competent authorities on the characteristics of a risk-based approach to AML/CTF supervision and the steps supervisors should take when conducting AML/CTF supervision on a risk-sensitive basis. The aim is to create both a common understanding of the risk-based approach to AML/CTF supervision and to establish consistent and effective supervisory practices across the EU, which should be consistent with FATF Recommendation 26 and its interpretative note. The ESAs are held to take specific account of the nature and size of a business and lay down specific measures where appropriate and proportionate.

In these guidelines, the risk-based approach to AML/CFT supervision is described as a cyclical process.

- Step 1 is the identification of ML/TF risk factors, whereby competent authorities obtain information on both domestic and foreign ML/TF threats affecting the relevant markets;
- Step 2 is the risk assessment, whereby competent authorities use this information to obtain a holistic view of the ML/TF risk associated with each subject of assessment, including the inherent risk to which that subject of assessment is exposed and the risk mitigants a subject of assessment has in place;
- Step 3 is the allocation of AML/CFT supervisory resource based on this risk assessment, which includes decisions about the focus, depth, duration and frequency of on-site and off-site activities, and supervisory staffing needs, including technical expertise ; and

- Step 4 is monitoring and review to ensure the risk assessment and associated allocation of supervisory resource remains up to date and relevant. This means that Step 4 can initiate again the identification of relevant information (Step 1), which may inform a new or updated risk assessment (Step 2), which in turn triggers new supervisory actions to mitigate those risks (Step 3).



This description is consistent with the FATF's interpretation of the RBS. It is also in line with the ESAs' 'Preliminary report on anti-money laundering and counter financing of terrorism Risk Based Supervision', which was published in October 2013 and upon which these guidelines are built^[2]. Competent authorities should apply these guidelines when carrying out risk-based AML/CFT supervision.

² Joint Committee of the European Supervisory Authorities : "Preliminary report on anti-money laundering and counter financing of terrorism Risk Based Supervision", JC-2013-72, October 2013,
<http://www.eba.europa.eu/documents/10180/16145/JC-2013-72+%28Report+on+Risk+Based+Supervision%29.pdf>
<https://eiopa.europa.eu/joint-committee/index.html>
<http://www.esma.europa.eu/content/Preliminary-report-anti-money-laundering-and-counter-financing-terrorism-Risk-Based-Supervis>

4. Joint Guidelines under Article 48 (10) of Directive (EU) 2015/849 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

The Risk-Based Supervision Guidelines

Status of these Guidelines

This document contains Joint Guidelines issued pursuant to Articles 16 and 56 subparagraph 1 of 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; Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority); and Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority)) - ‘the ESAs’ Regulations’. In accordance with Article 16(3) of the ESAs’ Regulations, competent authorities and financial institutions must make every effort to comply with the Guidelines.

Joint Guidelines set out the ESAs’ 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 to whom Joint Guidelines apply should comply by incorporating them into their supervisory practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where the Joint Guidelines are directed primarily at institutions.

Reporting Requirements

In accordance with Article 16(3) of the ESAs’ Regulations, competent authorities must notify the respective ESA whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by dd.mm.yyyy (two months after issuance). In the absence of any notification by this deadline, competent authorities will be considered by the respective ESA to be non-compliant. Notifications should be sent by submitting the form provided at Section 5 to compliance@eba.europa.eu, compliance@eiopa.europa.eu and compliance@esma.europa.eu /

[\[compliance@jointcommittee.europa.eu\]](mailto:compliance@jointcommittee.europa.eu) with the reference 'JC/GL/201x/xx'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities.

Notifications will be published on the ESAs' websites, in line with Article 16(3).

Title I - Subject matter, scope and definitions

Subject matter

1. These guidelines set out 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 as required by Article 48(10) of Directive (EU) 2015/849³.

Scope

2. These guidelines are addressed to competent authorities as defined in Articles 4(2)(ii) of Regulation (EU) No 1093/2010, 4(2)(ii) of Regulation (EU) No 1094/2010 and 4(3)(ii) of Regulation 1095/2010.
3. Competent authorities should apply these guidelines when designing, implementing, revising and enhancing their own AML/CFT RBS model.

Definitions

4. For the purpose of these Guidelines, the following definitions shall apply:

- | | |
|--|---|
| <ul style="list-style-type: none"> • Cluster | Means a group of subjects of assessment having similar characteristics. |
| <ul style="list-style-type: none"> • Competent authorities | Means the authorities competent for ensuring firms' compliance with the requirements of Directive (EU) 2015/849 as transposed by national legislation. ⁴ |
| <ul style="list-style-type: none"> • Other relevant AML/CFT authorities | Refers to all public authorities other than competent authorities with designated responsibilities for combating money laundering and/or terrorist financing. In particular, this includes the FIU; the authorities that have the function of investigating and/or prosecuting money laundering, associated predicate offences and terrorist financing, and seizing/freezing and confiscating criminal assets; authorities receiving reports on cross-border transportation of currency and bearer negotiable |

³ 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).

⁴ See Articles 4(2)(ii) of REGULATION (EU) No 1093/2010 , 4(2)(ii) of Regulation (EU) No 1094/2010 and 4(3)(ii) of Regulation 1095/2010

instruments; and authorities that have AML/CFT supervisory or monitoring responsibilities aimed at ensuring compliance by Designated Non-Financial Businesses and Professions (“DNFBP”) with AML/CFT requirements.

- Firm

Means a credit institution or a financial institution as defined in Article 3(1) and (2) of Directive (EU) 2015/849.
- Inherent money laundering/terrorist financing (‘ML/TF’) risk

Means the level of money laundering and terrorist financing risk before mitigation.
- Risk mitigants

Means measures to reduce ML/TF risk.
- Risk-based approach (RBA)

Means an approach whereby competent authorities and obliged entities identify, assess and understand the ML/TF risks to which firm are exposed and take AML/CFT measures that are proportionate to those risks
- Risk-based AML/CFT Supervision (RBS)

Means the risk based approach to AML/CFT supervision referred to in Art. 48(6) of Directive (EU) 2015/849, where the intensity and frequency of the AML/CFT supervision of firms are determined on the basis of the assessment of the ML/TF risks affecting these firms.
- AML/CFT RBS Model

Refers to the whole set of procedures, processes, mechanisms and practicalities allowing competent authorities to exercise their AML/CFT supervisory powers in a way that is commensurate to the identified ML/TF risks.
- ML/TF Risk

Means the likelihood and impact of ML/TF taking place. Risk refers to inherent risk.
- ML/TF risk factors

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

- **Risk profile** Means the overall level of risk that remains after mitigation.
- **Subject of assessment** Means any sectors or sub-sector of the financial system, a firm or group of firms, or a cluster, categorised according to criteria set up by the competent authorities.
- **Threat** Means the potential harm caused by a person or group of people, object or activity. In the ML/TF context, this includes the potential harm caused by criminals, terrorist groups and their facilitators, their funds, as well as past, present and future ML or TF activities.
- **Single Supervisory Mechanism** Means the system of financial supervision composed by the European Central Bank and the national competent authorities of participating Member States as described in Article 6 of Council Regulation (EU) No. 1024/2013⁵.

⁵ Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p.63).

Title II- Requirements regarding AML/CFT risk-based supervision

Implementing an RBS model

5. In order to establish and maintain an effective AML/CFT RBS model, competent authorities should apply the following four steps:
 - i. Step 1 – Collecting information and identifying ML/TF risk factors, including ML/TF threats and vulnerabilities;
 - ii. Step 2 – Risk assessment;
 - iii. Step 3 – Acting on the ML/TF risk assessment; and
 - iv. Step 4 – Monitoring and follow-up actions.
6. Competent authorities should note that the RBS is not a one-off exercise, but an on-going and cyclical process.
7. When first introducing a RBS model and prior to implementing Step 1, competent authorities should establish that they have adequate systems and processes to ensure all steps can be implemented.
8. Competent authorities may group less risky firms into 'clusters' and consider them as one single 'subject of assessment'. In that case, some elements of the RBS process may be conducted at the collective level of the cluster itself, rather than at the level of each individual firm within that cluster.
9. Competent authorities who cluster firms should ensure that the conditions and practicalities of the clustering are appropriate to the ML/TF risks associated with firms in that cluster.

Step 1: Identification of ML/TF risk factors

General provisions

10. As a first step, when applying a RBS model, competent authorities should gather sufficient information on relevant risk factors to be able to identify ML/TF risks to which the subjects of assessment are exposed.
11. The extent and type of information collected should be proportionate to the nature and size of the subject of assessment's business. It should also take into account its 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 which information they will always require and what type of information will trigger a more extensive and in-depth information request.

12. Competent authorities should consider the extent to which the guidelines on the risk factors to be taken into consideration by firms and the measures to be taken in situations where simplified or enhanced customer due diligence measures are appropriate, issued by the European Supervisory Authorities ('ESAs') in accordance with Articles 17 and 18 (4) of Directive (EU) 2015/849 can inform their identification of risk factors.
13. Where information on relevant ML/TF risk factors is held by other competent authorities, competent authorities should take steps to allow a timely exchange of that information, for example by concluding memorandums of understanding,.
14. To the extent permitted by applicable law, competent authorities should also exchange information with other relevant AML/CFT authorities about the ML/TF threats and vulnerabilities in the financial sector as a whole or within parts of it.

Information on risks factors affecting the relevant markets

Domestic risk factors

15. Competent authorities should have adequate knowledge, awareness and understanding of the ML/TF risks identified at the national level in order to understand the ML/TF risks associated with domestic financial activities carried out by the subjects of assessment.
16. Information to support this understanding may include, among others, information concerning:
 - the scale of money laundering linked to underlying criminal activities in the country;
 - the scale of laundering of proceeds from crime committed abroad;
 - the scale of, and the level of support for, terrorist activities and groups in the country;
 - relevant ML/TF typologies identified by the FIU and other public authorities or private entities.
17. As part of this exercise, competent authorities should refer to their Member State's national risk assessment ('NRA') (Article 7(1) of Directive (EU) 2015/849) and the European Commission's supranational risk assessment (Article 6(1) of Directive (EU) 2015/849). Competent authorities should ensure that they have mechanisms in place which allow them to be informed of, and kept up to date with, the NRA.
18. Where no NRA has been carried out or made available to competent authorities, or if the NRA appears to be out of date or incomplete, competent authorities should seek to identify other sources of reliable information on the ML/TF risks in their Member State. These may include, among others, information provided or published by other competent authorities, the FIU and other relevant AML/CFT authorities, reports from reputable international organisations and reliable information from credible statistical bodies, media reports and academic research.

Foreign risk factors

19. Where financial activities include significant business relationships with counterparts established in other Member States or in third countries, so that subjects of assessment are exposed to ML/TF risks associated with these other countries, competent authorities should identify these foreign risks.
20. As a first step, competent authorities should identify those foreign markets where subjects of assessment are significantly involved.
21. The results of the NRA conducted by the authorities in these other Member States or third countries may constitute an important source of information. Where no such NRA has been conducted or made publically available, or where the NRA appears to be incomplete or out of date, competent authorities should seek to identify other reliable sources of information on the ML/TF risks associated with that Member State or third country. This information could include other public information released by competent authorities of that country, reports from reputable international organisations and reliable information from credible statistical bodies, media reports, academic research (e.g. on the basis of the collection and analysis of criminal court decisions), among others. Competent authorities may also consider requesting relevant information from the competent authorities of that Member State or third country.
22. 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 whereby the Financial Action Task Force (FATF), Moneyval or another FATF Style Regional Bodies identify a particular third country as a high-risk or non-cooperative jurisdiction.
23. Competent authorities should take appropriate measures to keep informed of both the ESAs' joint opinion on the ML/TF risks affecting the Union's financial sector (Art 6(5) of Directive (EU) 2015/849) and the European Commission's supranational ML/TF risk assessment (Art 6(1) of Directive (EU) 2015/849) in order adequately to reflect these in their risk assessment.

Information on ML/TF risk factors at the level of the financial sector and sub-sectors

24. Competent authorities should have a detailed understanding of the risk factors that are relevant to the financial sector as a whole and each financial sub-sector, such as credit institutions, brokerage firms, investment firms, payment institutions, electronic money institutions, bureaux de change, or life insurance companies. As part of this, competent authorities should obtain information on how each sub-sector is organised, which jurisdictions they have links to and who or what their customers, products, services, transactions and delivery channels are.

25. Competent authorities may base their understanding of the sectoral and sub-sectoral risk factors on a high-level view of all information obtained from firms in the financial sector and sub-sectors about the ML/TF risks they face. Competent authorities can then identify commonalities within each financial sub-sector and the financial sector as a whole.

Information on ML/TF risk factors at the level of the subject of assessment

26. Competent authorities should gather sufficient, relevant and reliable information to develop an overall understanding of the subject of assessment's:
- inherent ML/TF risk and
 - risk mitigation, including information about any strengths and weaknesses.
27. The information competent authorities should obtain for this purpose may include information regarding:
- The ownership and corporate structure, taking into account whether the subject of assessment is an international or domestic institution, parent company, subsidiary, branch or other kind of establishment, and the level of sophistication of its organisation and structure.
 - The size of the subject of assessment's business, taking into account aspects such as assets, number of clients, or total deposits.
 - The nature and scope of the activities carried out, including in the form of free provision of services, and delivery channels, including product delivery structure such as services delivered through intermediaries.
 - The geographical area of the business activities, in particular whether they are carried out locally or in foreign countries, including high risk third countries.
 - The fitness and properness of senior managers, members of the management body and significant shareholders.
 - The quality of the corporate governance arrangements and structures, including the internal audit and compliance functions.
 - The overall 'corporate culture', with particular attention to the 'compliance culture' and to the culture of transparency and trust in the relations with the competent authorities.
 - The compliance with AML/CFT legal and regulatory requirements, including AML/CFT policies and procedures, organisational structure and resources of the AML/CFT compliance unit, and segregation of duties within the AML/CFT compliance unit and reporting lines.
 - The effectiveness of the implementation of internal AML/CFT procedures and internal controls to ML/TF risks, such as findings of internal and external audits related to AML/CFT, internal control policy or staff training program on AML/CFT.

- Supervisory records, such as results of supervisory actions for addressing significant deficiencies of the audit or compliance function, and specifically regarding AML/CFT, including sanctions or supervisory reports.
 - Other prudential and general aspects, such as years in operation, liquidity or capital adequacy.
28. 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.
29. Competent authorities should ensure that they have access to appropriate sources of information and take steps, where necessary, to improve them.
30. Where subjects of assessment are clusters of individual firms, competent authorities should take appropriate measures allowing them to use information such as that listed under paragraph 27 for characterising 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 firms included within that cluster.
31. However, when a competent authority obtains specific information about an individual firm included in a cluster that appears to indicate that the risks associated with this firm are significantly higher than the risk profile assigned to the cluster, the competent authority should record this information in an appropriate manner and reflect it in its supervisory planning. Where information in respect of an individual firm indicates that the inclusion of this firm within this cluster can no longer be justified, the individual firm should be removed from the cluster and assessed individually, on the basis of adequate individual information as listed under paragraph 27.

Step 2: Risk assessment

32. Competent authorities should use the risk factors identified under Step 1 as the basis for carrying out the subject of assessment's risk assessment.

Inherent risk level

33. Competent authorities should assess how risk factors identified under Step 1 affect the inherent risk of the subject of assessment being misused for ML/TF purposes. As part of this, competent authorities may decide that some risk factors are more relevant than others for a subject of assessment.
34. For reason of comparability, competent authorities may find it useful to employ a similar catalogue of inherent risk factors for subjects of assessment that are comparable to each other.

35. Competent authorities may also find it useful to develop some form of classification for the inherent risk level (e.g. low, medium, high risk level).

Risk mitigation

36. Once the inherent risk level has been identified, competent authorities should assess the extent to which the AML/CFT systems and controls the subject of assessment has in place are adequate and effectively mitigate the ML/TF risks to which the subject of assessment is exposed.
37. AML/CTF systems and controls include at least those listed in Art 8(4) of Directive (EU) 2015/849 as well as governance arrangements and risk management processes, including overall risk culture.
38. Competent authorities should assess the adequacy and effectiveness of these AML/CFT systems and controls, including an assessment of the subject of assessment's compliance with AML/CFT legal and regulatory requirements, by reference to existing supervisory reports (including those relating to previous AML/CFT visits or assessments), records of supervisory actions and other relevant information. Where no such information exists, the competent authority should reflect this in its risk assessment.
39. For reason of comparability, competent authorities may decide using a similar catalogue of risk mitigants for subjects of assessment that belong to the same category.
40. Competent authorities may find it helpful to develop some form of classification for the risk mitigants level (e.g. low, medium, high risk level).
41. Substantial deficiencies having the potential severely to affect the effectiveness of AML/CFT preventive measures should be given greater weight in the assessment than average or minor deficiencies.

Overall risk assessment

42. The combination of the assessment of the inherent risk level and the level of risk mitigants should result in the assignment of an overall risk profile to the subject of assessment. Competent authorities should consider classifying the different categories of risk profiles as low, medium and high risk to facilitate comparison between subjects of assessment, though other classifications are possible.
43. Competent authorities should use their professional judgement to validate the results of the overall risk assessment and correct it if necessary.

Step 3: Acting on the risk assessment

Planning supervisory actions

44. The ML/TF overall risk assessment should form the basis of the development of a supervisory strategy for the supervised sector as a whole and for each subject of assessment.

Individual AML/CFT supervisory plans

45. Competent authorities should plan supervisory activity for each subject of assessment in a way that is commensurate to the ML/TF risks identified, including by:
- determining appropriate supervisory actions including the focus, depth, duration and frequency of on-site and/or off-site activity, and
 - determining supervisory resources, including staffing needs and relevant technical expertise.
46. Competent authorities should recognise that firms exposed to high levels of ML/TF risk may not be systemically important. Therefore, when deciding on the most appropriate AML/CFT supervisory action, competent authorities should not rely solely on their prudential or conduct risk assessments, nor should they consider only systemically important firms. 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, be it high or low.
47. If a new risk is identified in the course of on-site or off-site supervision, competent authorities should respond appropriately; this may include amending the initial AML/CFT supervisory plan to better reflect the ML/TF risks to which the subjects of assessment are exposed. Competent authorities should adequately document any changes to the AML/CFT supervisory plan.

Overall AML/CFT supervisory plan

48. In order to ensure the balance between all individual AML/CFT supervisory plans established in accordance with the previous paragraphs, competent authorities should coordinate them within the overall AML/CFT supervisory plan that should be consistent with the overall identified ML/TF risks.

Resources

49. Competent authorities should ensure that sufficient resources are available to implement the overall AML/CFT supervisory plan and prioritise their allocation in line with the ML/TF risks identified.

Training

50. Competent authorities should ensure their staff is suitably qualified to exercise sound judgement and carry out risk-based AML/CFT supervision in an effective and consistent manner. As part of this, competent authorities should ensure staff has sufficient and up to

date AML/CFT expertise, including through training, recruitment and 'learning by doing'. Competent authorities may also benefit from knowledge sharing among competent authorities and other relevant AML/CFT authorities.

51. Competent authorities should consider how best to train their staff in the practical application of an AML/CFT RBS model. Supervisory staff should understand the general principles of RBS and its application. Training should be tailored to the responsibilities of the staff in charge of the AML/CFT supervision.

Step 4: Monitoring and follow-up actions

Updating the risk assessment and supervisory action plan (steps 1, 2 and 3)

52. Both general information regarding ML/TF risk factors identified in the relevant markets, the financial sector and sub-sectors and specific information related to subjects of assessment should be reviewed periodically and on an ad hoc basis, and updated as necessary.

Periodic reviews

53. Competent authorities should carry out periodic reviews of their risk assessments to ensure that they remain up to date and relevant.
54. The schedule of each review should be commensurate to the ML/TF risk associated with the subject of assessment. For high risk subjects of assessment or those facing frequent changes in their activities and operating in a fast changing environment reviews should take place more frequently.

Ad hoc reviews

55. Ad hoc review of the risk assessments should take place following significant changes that affect the subject of assessment's risk profile, such as major external events, emerging ML/TF risks, or developments in the shareholding, management, operations or organisation of the subject of assessment.
56. Ad hoc review of the risk assessment should also take place where the competent authority has grounds to assume that information on which it has based its risk assessment is no longer relevant or has significant shortcomings.
57. Competent authorities should satisfy themselves that the risk assessment of subjects of assessment remains relevant in light of the results of the off-site and on-site supervision and any follow-up of corrective or remedial actions taken by the subject of assessment.

Follow-up

58. Following the review of each risk assessment, competent authorities should satisfy themselves that their AML/CFT supervisory plan remains commensurate to the ML/TF risk and update their supervisory plan as appropriate.
59. Competent authorities should also consider whether changes that triggered a review of one risk assessment might affect other risk assessments and take steps to update these as necessary.

Review of the AML/CFT RBS model

60. Competent authorities should seek to satisfy themselves that their internal procedures, including their ML/TF risk assessment methodology, are applied consistently and effectively.
61. Where a review identifies issues with the AMF/CFT RBS model, competent authorities should take steps to address these. Ideally, the model should not be changed repeatedly within short time intervals to facilitate comparisons over time. This notwithstanding, competent authorities should review the methodology immediately where necessary.

Periodic reviews

62. Competent authorities should review periodically whether their AML/CFT RBS model delivers the intended outcome and in particular whether the level of supervisory resources remains commensurate to the ML/TF risks identified.
63. When reviewing the effectiveness of their AML/CFT RBS model, competent authorities may use a variety of tools, including professional expertise, using self-assessment questionnaires, sample testing of supervisory actions, comparison with new information such as reports and feedback from other competent or relevant AML/CFT authorities, law enforcement and other national agencies, or documents from relevant European or international organisations. Competent authorities should also seek to familiarise themselves with international best practices and consider participating in relevant international and European forums. Measuring the impact of AML/CFT supervision on 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.

Ad hoc reviews

64. In addition to a regular review at fixed intervals, competent authorities should review their AML/CFT RBS model whenever its implementation and effectiveness may be at stake due to significant events that are likely to require an update to, or amendment of, the model.
65. Significant events can be both internal and external events and may include, among others:

- Weaknesses identified pursuant to external evaluations of the model, such as FATF or Moneyval evaluation or external audits;
- Organisational changes in the supervisory system such as the creation of a new division or substantive increase in staff, change of board members or the management;
- Significant changes in the financial sector;
- Significant changes of the legislative or regulatory AML/CFT environment;
- Emergence or identification of new risk factors; and
- Findings from gap analyses and lessons learned exercises.

Organisational and procedural issues of the review process

66. An objective review process should be based on clear and transparent internal procedures. Such procedures should not only set out when a revision is due, but also the content and the persons in charge of the revision process. As regards the latter, the review of the AML/CFT RBS model may be carried out within the competent authority's team that had previously set up the model, by the competent authority's internal quality review team, internal audit or risk management team.
67. In addition to the internal review process, competent authorities may consider tasking an external expert to obtain an objective evaluation of its model or to ensure harmonization on a national level with the models used by other competent authorities.

Record keeping

68. Competent authorities should document the AML/CFT RBS model, its implementation, and subsequent reviews appropriately for its institutional (supervisory) memory but also in order to provide for rationale explanations for decisions and to ensure coherence among the actions taken by the competent authorities with regard to the different subjects of assessment.

Feedback and follow-up actions

Accountability

69. Senior management of the competent authorities should have an adequate understanding of ML/TF risks present in the supervised sector and sub-sectors and be regularly informed on AML/CFT supervisory actions and their outcome in order to take a view of the overall effectiveness of the measures implemented by the subjects of assessment to reduce these risks and the need to review, where appropriate, the intensity and frequency of the supervision and the allocation of supervisory resources.

Form of feedback

70. The findings of the ML/TF risk assessment should be shared with the relevant AML/CFT staff within the competent authority.
71. They may also inform the process of prudential and conduct supervision, or be relevant for a sectoral or national and risk assessment or policy changes, as well as the process of co-operation with other competent or relevant AML/CFT authorities.
72. Competent authorities should consider whether to provide feedback to stakeholders about the outcomes of the risk assessments and the supervisory actions. They could also be made available to trade and professional associations in order for them to take into account the results of the RBS and the identified risks and share the results among their members. The level of detail of information to be shared may vary depending on what could prove helpful to stakeholders and taking into account the interests of the competent authorities and the applicable confidentiality provisions.

Title III- Implementation

Implementation

73. Competent authorities should comply with these guidelines by the earlier of the following dates:
- 26 June 2017;
 - The date on which the Member State of the relevant competent authorities brings into force the laws, regulations and administrative provisions necessary for it to comply with Directive (EU) 2015/849.

5. Accompanying documents

5.1. Impact Assessment

Introduction

1. Directive (EU) 2015/849 places the risk-based approach at the centre of the Union's anti-money laundering and counter terrorist financing (AML/CFT) regime. It makes clear that the risk of money laundering and terrorist financing (ML/TF) is not the same in every case and that a risk-based approach helps effectively to manage those risks. It sets out a number of requirements competent authorities have to meet when applying a risk-based approach to AML/CFT supervision (RBS) and requires the European Supervisory Authorities (ESAs) to issue guidelines on the characteristics of the RBS and what competent authorities should do when conducting AML/CFT supervision on a risk-sensitive basis.
2. In 2012/13, ESAs carried out work to clarify the concept of the RBS and assess its implications for competent authorities. The ESAs published their findings in a 'Preliminary report on anti-money laundering and counter financing of terrorism Risk Based Supervision' ('preliminary report') in October 2013 ^[6].

Scope and objectives

3. This impact assessment sets out how different policy options the ESAs considered when drafting the guidelines under Article 48(10) of Directive (EU) 2015/849 might affect their stakeholders.
4. The ESAs considered the views of expert AML/CFT competent authorities and found that the implementation of a RBS would not have a material net impact on firms or competent authorities in the EU.
5. In light of this, the ESAs considered that it would not be proportionate to carry out a full, quantitative assessment of the costs and benefits arising from the implementation of the proposed guidelines by competent authorities. Instead, this impact assessment examines, in qualitative terms, the impact these guidelines would have if all competent authorities that apply, or will apply, a RBS fully complied with them. This means that the estimated

⁶ Joint Committee of the European Supervisory Authorities : "Preliminary report on anti-money laundering and counter financing of terrorism Risk Based Supervision", JC-2013-72, October 2013,
<http://www.eba.europa.eu/documents/10180/16145/JC-2013-72+%28Report+on+Risk+Based+Supervision%29.pdf>
<https://eiopa.europa.eu/joint-committee/index.html>
<http://www.esma.europa.eu/content/Preliminary-report-anti-money-laundering-and-counter-financing-terrorism-Risk-Based-Supervis>

net impact of the preferred options should be interpreted as the maximum impact from the full implementation of the proposed guidelines; the impact from the actual implementation of these guidelines could be less.

Baseline

6. Directive (EU) 2015/849 requires competent authorities to meet the requirements in Article 48(6) when applying the RBS. It also mandates the ESAs, in Article 48(10), to issue guidelines on not only the characteristics of the RBS, but also on the steps supervisors should take when conducting supervision on a risk-sensitive basis.
7. Since the requirements in Article 48(6) are insufficient to satisfy the mandate in Article 48(10), not issuing guidelines, or limiting the guidelines to the requirements in Article 48(6), is not an option.

Considered options

Approach

8. The ESAs considered whether to base their guidelines on the approach set out in the ESAs' preliminary report.

Option 1: adopt the same approach.

9. These guidelines could adopt the same approach as that set out in the preliminary report.
10. The approach set out in the preliminary report reflects a common understanding by all EU AML/CFT supervisors of what the RBS entails. It is in line with international standards and recommendations and its validity has not been questioned by national competent authorities while it was being drafted and since it has been published.

Option 2: adopt a different approach.

11. These guidelines could adopt a different approach.
12. Adopting a different approach would mean re-assessing the meaning of the RBS in the context of Directive (EU) 2015/849 and international standards.
13. Not following the approach set out in the preliminary report would risk jeopardizing the common understanding. It would also risk leading to the adoption of an approach which is inconsistent with international standards, upon which the preliminary report is based.
14. Adopting a different approach would therefore risk exposing Member States and competent authorities to international censure.
15. Option 1 is the ESAs' preferred option.

Level of detail

16. The ESAs considered the level of detail that would be appropriate to achieve both supervisory convergence and a consistent approach to AML/CFT supervision, and sufficient flexibility for national competent authorities to take account of the specificities of their regime and financial markets, including their scale; the number, size and nature of supervised entities; the ML/TF risks; and the organisation of AML/CFT supervision. The ESAs were mindful that these indicators can vary significantly from one Member State to another.

Option 1: High-level principles

17. Competent authorities could decide themselves how to design and apply their RBS model within a high-level, outcome-focused framework set by the guidelines.
18. This approach would provide competent authorities with significant flexibility to tailor their approach to the specificities of their regime and financial markets; but this approach would not be conducive to the convergence of supervisory practices and risk creating regulatory arbitrage. It would also offer little assistance to competent authorities seeking to review, create or implement their RBS and might be unsuitable for competent authorities with limited prior exposure to the RBS.

Option 2: Detailed and prescriptive guidelines

19. The guidelines could provide competent authorities with a detailed, step-by-step guide to implementing a RBS.
20. This approach would be conducive to fostering convergence of supervisory practices, but it would leave very limited or no opportunities for competent authorities to adapt their RBS model to suit their particular circumstances.
21. As a result, there would be a risk that this approach could be disproportionate or ineffective in at least some cases. It could also be incompatible with the basic premise of the risk-based approach, which is to adjust the supervisory response to the level of risk relevant financial markets are exposed to.

Option 3: High-level principles with elements of specific guidance

22. The guidelines could set out high level principles, which reflect the common understanding of the RBS; these high level principles would be complemented with sufficient detail to achieve supervisory convergence while providing room for competent authorities to adjust their approach in line with their legal and regulatory environment and the realities of their financial sector.
23. Option 3 is the ESAs' preferred option.

Cost-benefit analysis

24. These Guidelines will affect how competent authorities approach risk-based AML/CFT supervision, which may in turn have cost implications for obliged entities. However, the impact of these guidelines will vary from one Member State to another due to the existing divergence of supervisory practices and the degree to which national competent authorities have already applied a RBS in line with that set out in Directive (EU) 2015/849.

Benefits

25. In line with Regulations (EU) 1093/2010, 1094/2010 and 1095/2010, these Guidelines are designed to foster consistent, efficient and effective supervisory practices within the EU and to ensure the common, uniform and consistent application of Union Law. They will help competent authorities comply with their obligations under national legislation transposing Directive (EU) 2015/849 and exercise their functions in a way that is both effective and compatible with international AML/CFT standards.
26. Effective AML/CFT supervision is key to ensuring that firms have in place and maintain effective policies and procedures to prevent and detect money laundering and terrorist financing.

Costs

For competent authorities

27. Based on the considerations set out above, these guidelines may create incremental operational costs for those competent authorities that do not already apply a RBS and may create incremental opportunity costs for those who will wish to review their RBS to ensure it is in line with what these guidelines require. However, these are likely to be one-off costs; in the medium to long term, applying these guidelines should help competent authorities allocate existing supervisory resources more effectively, so the ongoing cost of applying these guidelines is likely to be fully absorbed.

For firms

28. Based on the considerations set out above, these guidelines may create one-off, incremental costs for firms in jurisdictions where competent authorities do not yet apply a RBS, or where competent authorities will amend their RBS to bring it in line with these guidelines as some firms may have to provide additional information to their competent authorities. However, since competent authorities will be able to refer to information they already possess or would require for wider conduct of business and prudential supervision, these costs are unlikely to be significant.
29. These guidelines may also create ongoing incremental costs for firms that are being assessed as presenting a greater ML/TF risk as they may be subject to greater supervisory

scrutiny. This will particularly be the case for firms whose prudential risk profile is low but whose ML/TF risk profile is heightened. However, it is likely that a far greater number of firms will have low ML/TF risk profiles and be subject to less supervisory scrutiny than at present; this means that applying these guidelines will generate a net benefit for the financial services sector as a whole.

5.2. Overview of questions for Consultation

1. These guidelines are addressed to competent authorities. Answers to the following questions would be particularly helpful:

- Do you agree with the way the risk-based approach to supervision is described in these guidelines?
- In particular, do you agree that the four steps in these guidelines reflect the essential components of a risk based approach to supervision?

If you do not agree, what else do you think supervisors should focus on? Please explain by providing details on the principles you believe form part of an alternative approach. Please also clarify how this alternative approach meets the requirements of Directive (EU) 2015/849 and the international standards (FATF Recommendations).

- Do you consider that the level of detail in the guidelines is appropriate?

If you do not consider that it is appropriate, where do you think additional, or less, detail would be warranted?

- What do you think the impact of these guidelines will be on the financial services industry?