Financial Crime Risk definition and regulatory context

"The criminal element now calculates that crime really does pay"
Ronald Reagan[23]

Financial Crime refers to illegal acts committed by an individual or group of individuals to obtain personal financial gain utilizing the means of financial services or financial markets. Although there are different definitions of what Financial Crime entitles[24], under this concept the actions of ML/TF, bribery, market abuse, or fraud are considered[25].

Two definitions of Financial Crime from FCA and FDIC are highlighted:

> *"Any kind of criminal conduct relating to money or to financial services or markets, including any offence involving: (a) fraud or dishonesty; or (b) misconduct in, or misuse of information relating to, a financial market; or (c) handling the proceeds of crime; or (d) the financing of terrorism"*[26]

> *"Legal entities can be abused to disguise involvement in terrorist financing, money laundering, tax evasion, corruption, fraud, and other financial crimes"*[27]

Creating the means to identify and prosecute illicit financial crimes in their different forms have triggered the enactment of different supervisory and regulatory initiatives. The two critical actions promoting greater global coordination on ML regulation were the constitution of the Financial Action Task Force (FATF)[28] and the UN's ratification of the Convention on Transnational Organized Crime[29], the first AML treaty. As part of the FATF, the Member States are required to comply with global AML standards. These standards[30] broadly define the core components of any modern AML program at any financial institution:

- Implement Know Your Customer (KYC) ID verification measures.
- Perform FATF recommended due diligence measures.
- Maintain suitable records of high-risk clients.
- Regularly monitor accounts for suspicious financial activity and report that activity to the appropriate national authority.
- Enforce effective sanctions against legal persons and obliged entities that fail to comply with FATF regulations.

On the other hand, the FATF's principles and the UN's Convention agreements created a consensus to start working on the identification of ML/TF practices, and more importantly, to stop them.

During the last decades, the concept of AML has evolved differently, as well as the various regulations, depending among other things on the changing nature of CTF financial activities. Key trends noted in international Financial Crime activities include:

- Tight restrictions on transactions in most jurisdictions, which increases the appetite of financial criminals to divert to other types of activities such as crypto and digital currency in incipient stages of control and regulation.
- Customer attitudes, preferences and behaviour changing, with increasing focus on digital banking services[31], which will be the target of financial criminals (e.g., virtual assets, custodian wallets, fiat currencies, pre-paid cards).

[23] Ronald Wilson Reagan (1911-2004) was an American actor, statesman and politician who served as the 40th President of the United States (1981-1989) and 33rd Governor of California (1967-1975).

[24] Some regulatory or supervisory bodies, such as FCA, provide "closed" definition of the term "financial crime" and the actions considered within, whilst others may claim responsibility for assessing, regulating and supervising certain illegal acts that might qualify as financial crime (e.g., FINCEN). The identified actions of ML and TF are nevertheless core to any financial crime supervisory program.

[25] Other illegal acts with financial gains implied that are subject to overall regulation include: identity theft, corruption, tax evasion, embezzlement, forgery, counterfeiting.

[26] Financial Conduct Authority (2021).

[27] Appendix A to § 1010.230—Certification regarding beneficial owners of legal entity customers , FDIC Law, Regulations, Related Acts.

[28] FATF (2019).

[29] UN Office on Drugs and Crime (2005).

[30] Despite the complexity of the topic and the constant evolution of the ML tactics and available technology for it, these standards remain at the core of the AML programs worldwide and address AML evaluation requirements: customer risk rating assessment, transaction monitoring program and sanction screening program. Standards relating to high-risk customers are especially important, as the risk-based approach is quintessential to the definition of any AML program.

[31] This trend has been exacerbated as a result of the COVID19 pandemic.

- Increased international financial activities facilitated by available technologies has fostered new global consumption requirements, which creates new channels for illicit financial activities.

The complexity of the current environment is forcing the regulatory authorities to take action and address the modernization of the Financial Crime programs in light of these transformative elements.

Regulatory changes for 2021 and 2022 that pertain to Financial Crime are expected to focus on:

- Stricter restrictions to prevent ML in "non-traditional" circuits, e.g., new rules for digital transactions.
- Increasing focus on the foundations of the KYC program to monitor customer risks and to therefore reinforce the AML regulation.
- Introduction of new technologies and analytics (e.g., cloud services, machine learning / artificial intelligence model, advanced analytics) to move to real-time identification and optimized resources use.
- Coordination across jurisdictions to improve Financial Crime programs.
- Public and private cooperation and development of platform for sharing information.

One of the most important regulatory trends has been the strengthening of interbank and inter-jurisdiction collaboration with the aim of increasing the capabilities of data sharing and information on financial crimes and creating homogenous rules that could act in coordination[32]. Although these initiatives are in the earliest stages, they are proving successful (as has been seen, for example, in the reaction of different regions to the Russia invasion of Ukraine, and the corresponding sanctions imposed on Russian economic interests).

Regulatory landscape across different jurisdictions

The United States have been developing regulation in this regard since 1970. However, in recent years new regulation has been issued to update the existing corpus:

- The AML Act of 2020[33] modernized the Act of 1970 (BSA/AML) incorporating critical elements to address ML and fraud issues in alignment with the current trends.
- Same regulation acted on the requirements for Ultimate Beneficial Owners. Banks will have better visibility on the ultimate beneficiary of a transaction, which will enact reinforced customer due diligence (CDD) and reduce ML and fraud activities.
- Cryptocurrency exchanges should complete the KYC process for each customer[34].

In the case of the European Union, the EC presented a package with four legislative proposals related to AML/CTF[35]. The objective of this new legislative package is to address the differences in national regulations and increase coordination among member states.

The UK government is actively working to comply with international AML standards and considering the introduction of national priorities into the AML Act[36]. The government is progressing its 2019-2022 Economic Crime Plan[37] to strengthen Financial Crime frameworks. In its latest statement of progress on this Plan, several core actions were developed that build on the original actions within the Economic Crime Plan[38,39].

In China, CBIRC issued new measures[40] to encourage financial institutions to effectively fulfill their AML/CTF obligations and regulate the supervision and administration of AML/CTF.

Japan has recently issued AML/CTF guidelines[41] that also prescribe a risk-based approach that complies with international standards, such as the FATF.

In Singapore, the Payment Services Act[42] was updated in January 2021. This regulation provides a flexible framework for payment systems and payment service providers in the country. Recently the Monetary Authority of Singapore (MAS) also published two consultation papers that seek to strengthen the regulatory framework surrounding money laundering[43].

[32] FATF included in their agenda the public private partnership (PPP) initiative. Different regulators have also launched similar initiatives.
[33] FinCEN.gov (2020).
[34] Apart from this important addition to the KYC rules, other regulations on virtual assets were issued by the U.S. Securities and Exchange Commission, Commodity Futures Trading Commission and FinCEN to reinforce the framework of control of these assets in the US.
[35] Regulation to establish an EU AML/CTF authority; Regulation for applicable AML/CTF rules (Single Rulebook) and entities subject to them; Directive 6 on AML/CTF (AMLD6) replacing previous one, to be transposed into national law with rules for national supervisors and FIUs in Member States and Regulation on Transfers of Funds
[36] The Institute of International Finance and Deloitte (2021).
[37] HM Government (2019).
[38] HM Government (2021).
[39] i) Design and deliver a comprehensive Fraud Action Plan; ii) Bolster public-private operational action to tackle known vulnerabilities enabling the flow of illicit finance within and out of the UK; iii) Improve the effectiveness and efficiency of the whole system response to economic crime, increasing high value intelligence to law enforcement and reducing low value activity that costs business and delivers little benefit; iv) Continue to deliver SARs reform, including the next stages of rollout of the new IT infrastructure and the increase in UK Financial Intelligence Unit staffing; v) Finalize the Sustainable Resourcing Model to support economic crime reform, vi) Develop legislative proposals to tackle fraud, ML, seize more criminal assets, and to strengthen corporate transparency and vii) Capitalize on the G7 Presidency to strengthen the overall international response to illicit finance and anti-corruption.
[40] Institutions. People's Bank of China (2020).
[41] Financial Services Agency (2021).
[42] Republic of Singapore (2019).
[43] See: Consultation Paper on Proposed AML Notices for Cross-Border Business Arrangements of Capital Markets Intermediaries under Proposed Exemption Frameworks. Monetary Authority of Singapore. May 12, 2021, and Consultation Paper on the FI-FI Information Sharing Platform for AML/CTF. Monetary Authority of Singapore. October 2021.

The following list contains the main supervisory and regulatory bodies acting on the Financial Crime program implementation and the core regulations and guidelines. The historical evolution explains the major focus on AML/CTF.

United States – Regulatory Body: FinCEN

- *Bank Secrecy Act (BSA), Currency and Foreign Transactions Reporting Act of 1970* | 26-Oct-70. Defines the regulatory framework for U.S. financial institutions to assist U.S. government agencies to detect and prevent money laundering, including transactions exceeding $10,000, report suspicious activity that might signify money laundering, tax evasion, or other criminal activities.
- *Title III USA PATRIOT Act of 2001* | 26-Oct-01. Section 314 helps identification, disruption and prevention of terrorist act and money laundering activities.
- *Corporate Transparency Act of 2019* | 11-Jun-19. Requires new and existing entities to report beneficial ownership information to the Financial Crimes Enforcement Network ("FinCEN"), creates a beneficial ownership database, and institutes civil penalties, fines, and criminal sanctions for noncompliance.
- *AML Act of 2020 (US AMLA)* |1-Jan-21. Requires FinCEN to establish national AML/CTF priorities for FIs to incorporate them into their AML/CTF programs, and collect and report additional information on account holders, including information on ownership and control. It also requires regulators and examiners to incorporate into rules, guidance, and examinations.
- *Anti-Money Laundering and Countering the Financing of Terrorism National Priorities* | 30-Jun-21. Government-wide priorities for anti-money laundering and countering the financing of terrorism.

United Kingdom - Regulatory Body: UK Gov't

- *Proceeds of Crime Act 2002* | 24-Jul-02. Established the Assets Recovery Agency and made provision about the appointment of its Director and his functions (including Revenue functions) and sets out the legislative scheme for the recovery of criminal assets.
- *Criminal Finances Act 2017* | 27-Apr-17. An Act to amend the Proceeds of Crime Act 2002; make provision in connection with terrorist property; create corporate offences for cases where a person associated with a body corporate or partnership facilitates the commission by another person of a tax evasion offence; and for connected purposes.
- *The Money Laundering, Terrorist Financing and Transfer of Funds Regulations 2017* | 28-Jun-17. The Treasury are designated for the purposes of section 2(2) of the European Communities Act 1972 in relation to the prevention of money laundering and terrorist financing.

United Kingdom - Regulatory Body: FCA

- *Financial Services Act of 2012* | 19-Dec-12. An Act to amend the Bank of England Act 1998, the Financial Services and Markets Act 2000 and the Banking Act 2009; to make other provision about financial services and markets; to make provision about the exercise of certain statutory functions relating to building societies, friendly societies and other mutual societies; to amend section 785 of the Companies Act 2006; to make provision enabling the Director of Savings to provide services to other public bodies; and for connected purposes.

United Kingdom - Regulatory Body: JMLSG

- *Guidance for AML and combating terrorism finance* |20-Dec-21. Sets out what is expected of firms and their staff in relation to the prevention of money laundering and terrorist financing but allows them some discretion as to how they apply the requirements of the UK AML/CTF regime in the particular circumstances of the firm, and its products, services, transactions and customers.

European Union - Regulatory Body: EC

- *Anti-Money Laundering Directive* | 9-Jun-18. Set out factors that firms should consider when assessing the ML/TF risk associated with a business relationship or occasional transaction. In addition, they provide guidance on how financial institutions can adjust their customer due diligence measures to mitigate the ML/TF risk they have identified so as to make them more appropriate and proportionate. Finally, they support competent authorities' AML/CTF supervision efforts when assessing the adequacy of firms' risk assessments and AML/CTF policies and procedures.
- *Commission Delegated Regulation (EU) 2019/758* | 31-Jan-19. Regulatory technical standards for the minimum action and the type of additional measures credit and financial institutions must take to mitigate money laundering and terrorist financing risk in certain third countries.
- *Proposal for a 6th Directive on AML/CTF (AMLD 6)* | 20-Jul-21. Directive on the mechanisms to be put in place by the Member States for the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and repealing Directive (EU) 2015/849.
- *Anti-money laundering and countering the financing of terrorism legislative package* | 20-Jul-21. The package includes a proposal for the creation of a new EU authority to fight money laundering. It is part of the Commission's commitment to protect EU citizens and the EU's financial system from money laundering and terrorist financing. The aim is to improve the detection of suspicious transactions and activities, and close loopholes used by criminals to launder illicit proceeds or finance terrorist activities through the financial system.

European Union - Regulatory Body: EBA

- *Guidelines on policies and procedures in relation to compliance management and the role and responsibilities of the AML/CTF Compliance Officer* | 14-Jun-22. The guidelines comprehensively address, for the first time at the level of the EU, the whole AML/CTF governance set-up. These guidelines specify the role, tasks and responsibilities of the AML/CTF compliance officer, the management body and senior manager in charge of AML/CTF compliance as well as internal policies, controls and procedures. They complement, but do not replace, relevant guidelines issued by the European Supervisory Authorities on wider governance arrangements and suitability checks.

European Union - Regulatory Body: ESMA

- *2020 Annual Report on the EU Market Abuse Sanctions* | 20-Oct-21. The Report describes an increase in the number of administrative sanctions and measures in 2020 compared to 2019, reaching 541 from 279 the preceding year. However, it also found that the financial penalties imposed are significantly lower, reaching only €17.5 million in 2020, compared to €82 million in 2019.
- *Action Plan for a comprehensive Union policy on preventing money laundering and terrorist financing* | 13-May-20. In its Communication Towards better implementation of the EU's anti-money laundering and countering the financing of terrorism framework and accompanying reports of July 2019, the Commission set out the measures needed to ensure a comprehensive EU policy on preventing money laundering and countering the financing of terrorism (AML/CTF). These include better implementation of existing rules, a more detailed and harmonized rulebook, high-quality and consistent supervision,

including by conferring specific supervisory tasks to an EU body, interconnection of centralized bank account registries and a stronger mechanism to coordinate and support the work of the Financial Intelligence Units (FIUs).

China - Regulatory Body: BIRC

- *Measures for the Supervision and Administration of Anti-Money Laundering and Counter-Terrorist Financing of financial institutions* | 1-Aug-21. In order to cause financial institutions to effectively fulfill their anti-money laundering and anti-terrorist financing obligations and regulate the supervision and administration of anti-money laundering and anti-terrorist financing, the People's Bank of China formulated the Measures for the Supervision and Administration of Anti-Money Laundering and Anti-Terrorist Financing (the "Measures") in accordance with the Anti-Money Laundering Law of the People's Republic of China, the Banking Law of the People's Republic of China and the Anti-Terrorism Law of the People's Republic of China.

Japan - Regulatory Body: FSA

- *Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism* | 19-Feb-21: The Financial Services Agency ("FSA"), with necessary supervisory measures, shall monitor the AML/CTF measures of each Financial Institution, share the outcome with financial institutions, and urge them to enhance risk management. The Guidelines clarify the required actions and expected actions to be implemented by each Financial Institution and how the FSA shall conduct monitoring going forward.

India - Regulatory Body: FIU

- *Prevention of Money Laundering Act* | 17-Jan-03. An Act of the Parliament of India enacted by the NDA government to prevent money-laundering and to provide for confiscation of property derived from money-laundering.

Australia - Regulatory Body: AUSTRAC

- *Financial Transaction Reports Act 1988* | 16-Apr-18. The FTR Act was introduced to assist in administering and enforcing taxation laws as well as other Commonwealth, state and territory legislation.

- *Anti-Money Laundering and Counter-Terrorism Financing Act* | 12-Dec-06. Provides for measures to detect, deter and disrupt money laundering, the financing of terrorism, and other serious financial crimes; and provides relevant Australian government bodies and their international counterparts with the information they need to investigate and prosecute money laundering offences, offences constituted by the financing of terrorism, and other serious crimes.

South Africa - Regulatory Body: FIC

- *Financial Intelligence Centre Act* | 28-Mar-03. Establishes the country's Financial Intelligence Centre (FIC) and introducing a basic framework to bring the country's AML/CTF regulations into alignment with those of the wider international community. This act was strengthened by the Financial Intelligence Centre Amendment Act 1 of 2017, introducing a risk-based approach to customer due diligence.

Global - Regulatory Body: UN

- *Convention against Transnational Organized Crime and the Protocols Thereto* | 15-Nov-00. The purpose of this Convention is to promote cooperation to prevent and combat transnational organized crime more effectively.

Global - Regulatory Body: OECD

- *International Co-operation* | 14-Jun-12. This OECD report contains a compilation of a variety of international regulations on financial crime.

- *Against Tax Crimes and Other Financial Crimes* | 14-Jun-12. This OECD report contains a compilation of a variety of international regulations on financial crime.

Global - Regulatory Body: FATF

- *FATF Recommendations 2012* | Oct-21.The FATF Recommendations set out a comprehensive and consistent framework of measures which countries should implement in order to combat money laundering and terrorist financing, as well as the financing of proliferation of weapons of mass destruction. Countries have diverse legal, administrative and operational frameworks and different financial systems, and so cannot all take identical measures to counter these threats.

- *FATF Methodology 2013* | *Nov-20.* The FATF conducts mutual evaluations of its members' levels of implementation of the FATF Recommendations on an ongoing basis. These are peer reviews, where members from different countries assess another country. The FATF Methodology for assessing compliance with the FATF Recommendations and the effectiveness of AML/CTF systems sets out the evaluation process.

- *Procedures for the FATF Fourth Round of AML/CTF Mutual Evaluations* | Jan-21. The FATF is conducting a fourth round of mutual evaluations for its members based on the FATF Recommendations (2012), and the Methodology for Assessing Compliance with the FATF Recommendations and the Effectiveness of AML/CTF Systems (2013), as amended from time to time. This document sets out the procedures that are the basis for that fourth round of mutual evaluations.

- *Consolidated Processes and Procedures for Mutual Evaluations and Follow-Up* | Jan-21. The Consolidated Processes and Procedures for Mutual Evaluations and Follow-Up set out the core elements that form the basis for all evaluations and are based on the Procedures for the FATF 4th Round of AML/CTF evaluations.

Global - Regulatory Body: BCBS

- *Core Principles for Effective Banking Supervision* | Oct-06. The Core Principles have been used by countries as a benchmark for assessing the quality of their supervisory systems and for identifying future work to be done to achieve a baseline level of sound supervisory practices.

- *Guidelines on the Prudential Management of Risks Related to Money Laundering and Terrorist Financing (AML/CTF)* | Jul-20. These guidelines are intended to enhance the effectiveness of the supervision of banks' money laundering and terrorist financing (TF) risk management, consistent with and complementary to the goals and objectives of the standards issued by the Financial Action Task Force (FATF) and the principles and guidelines issued by the Basel Committee.

- *Updated guidelines for a risk-based approach to virtual assets and virtual asset service providers* | Oct-21. The Financial Action Task Force (FATF) published in October 2021 a set of guidelines setting out how the FATF recommendations should be applied in the context of distributed accounting technology and cryptocurrencies.