

AML State of Play

- *An FCG Insights Report*



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Foreword

The prevention of financial crime and money laundering has become a major concern in the financial industry in recent years. All over the world, countries are facing significant economic and social costs due to illegal activities such as human trafficking, corruption, tax evasion, and drug trafficking. Monitoring and preventing the illegal flow of money is vital to efforts to tackle financial and organized crime. Thus, banks and other financial institutions are in a unique position to make a difference and are part of the solution.

However, combating financial crime requires constant work and collective efforts due to the complex and changing environment in which we operate. The speed of digitalization and changing consumer behavior patterns continue to open up new risks for money laundering and financial crime at large. The Covid-19 pandemic has also left many businesses and individuals in financial distress, making them easy targets for criminals looking to exploit vulnerabilities and lure them into criminal activities.

At the same time, efforts to develop anti-money laundering (AML) measures and financial crime prevention are still in their infancy. Through investments in new technologies and know-how, we at FCG see great opportunities to build more effective tools to identify, assess, and mitigate risks associated with financial crimes. To be successful, however, the industry must develop and implement proactive controls and risk management methods with greater efficiency.

We also see a general need for more and better data, which in combination with increased use of machine learning, natural language processing, and other forms of artificial intelligence (AI) technologies can pave the way for a new generation of improved risk-based methods in financial crime prevention.

With this report, we want to share important insights on these matters, and contribute to the development of a sound and successful financial services industry so that banks and other operators can stay one step ahead of financial crime.

I would like to express our sincere thanks to the AML experts at ten leading financial institutions in the Nordics who agreed to be interviewed for this report, and so generously contributed with their time and insights.

Stockholm, March 2022

Kristian Bentzer
CEO

1. Executive summary

Sanctions by the Financial Supervisory Authorities have led to massive investments in AML and a scramble for competent resources. Frequent regulatory changes in the last years have left financial institutions in a state of constant upgrading. Meanwhile, preventing money-laundering will require collective efforts and more collaboration both between authorities and with the private sector.

While AML is already a top priority of the board of directors, this report suggests that skills shortage is still a problem, and more training including on top level is needed. How well the board understands AML will influence the tone at the top as well as the boards' ability to ask the right questions. A further observation is that the ability of relevant authorities to communicate around AML, including what information that these provide, has an impact on the level of attention and awareness of boards.

Competence is also regarded as the primary key to effective risk management and ensuring a risk-based approach across operations. The report concludes that views on customer due diligence (Know-Your-Customer, "KYC") vary significantly. On the one hand KYC is regarded as a formality of little use, on the other hand it is seen as a highly underused source of business intelligence that could be much better explored.

Organisations have yet to grasp how to they can best generate business value from AML processes. How highly AML is prioritised is mostly a direct result of how much value it is thought to add. AML is directly related to trust, the most important asset of any organisation, as well as ESG which is clearly on the rise, and thereby investor interest and customer loyalty.

With regards to the fast technology developments, many organisations carry a heavy burden of legacy structures that stand in the way to progress. At the same time, they have to cope with new and evolving regulatory requirements. Future perspectives and recommendations include working towards better understanding of material risk and continuously addressing the risk-based approach, strengthening board competence, striving for a holistic approach to be able to prevent silo-thinking, and at the same time, dealing with the actual purpose so that legacy systems and sunk costs can be managed and information shared within and across organisations.

Among the 5 rating questions in this report, 'setting key performance indicators' was rated as the relatively least developed issue area, and 'effective sanctions screening models' as the most developed. Other issue areas covered include the defining of risk appetite, key risk indicators and the efficiency of transaction monitoring.

2. About this Report

This report describes the current state of play for financial crime prevention, with a particular focus on anti-money laundering (AML). It aims to share new insights and offer forward-looking perspectives that can add value to the sector as a whole. The report is based on ten qualitative interviews, and thus does not rely on academic or statistical references.

The analysis is based on interviews with AML experts at ten leading Nordic financial institutions based in Sweden. Both large traditional banks as well as neobanks were invited to participate.

The respondents hold positions such as e.g. Head of AML, Country AML Responsible, Head of Financial Crime Prevention, and Chief Compliance Officer. We are tremendously grateful to those who participated and so generously gave their time. To ensure anonymity, quotes are simply noted as said by a Senior AML Officer.

The analysis for this report is based on responses to five open questions that generated open discussion and five rating questions where responses were limited to a scale from 1 to 10. The interviews were conducted anonymously in November and December 2021.

All observations and comments made are general, discussing the financial sector at large, and not specific in relation to any individual financial institution. All opinions expressed in this report are those of the respondents unless otherwise stated. All statements and citations are anonymous. "They" is used as gender-neutral pronoun, and covers both he/him and she/her.

Abbreviations

AML	Anti-Money Laundering
CTF	Counter Terrorism Financing
ESG	Environmental, Social, and Governance
FCP	Financial Crime Prevention
FIU	Financial Intelligence Unit
FSA	Financial Supervisory Authority
KYC	Know Your Customer
KPI	Key Performance Indicator
KRI	Key Risk Indicator
PEP	Politically Exposed Person
UBO	Unique Beneficiary Owner

3. Background

Money laundering and financial crime prevention at large are among the most critical issues facing the global financial services industry. According to the United Nations, criminal proceeds worth 2 to 5 percent of global GDP are laundered every year.

The pandemic has accelerated digitalization, resulting in an increasing number of new digital financial services and products such as mobile money. This trend has taken the laundering of dirty money to new levels, forcing financial institutions, FIUs and, FSAs to address a new set of risks and challenges. Meanwhile, transaction volumes are growing, and new regulatory requirements are either in force or will come into play in near future.

Over the past decade, 18 out of Europe's 20 largest banks have been sanctioned for money laundering offences. Revelations that several North European banks were involved in systematic money-laundering of unprecedented scale proved an important tipping point. This made clear that AML is an extremely complex challenge for all financial institutions, irrespective of size or seeming sophistication. Aside from sanctions, the potential loss of trust became a key concern.

In recent years, banks have invested billions in AML. However, seemingly unsatisfactory results have led to debate about the return on those investments. Following problems in the Baltic region, the CEO of a major Swedish bank told the Financial Times in late 2021 that his company had spent more time on AML issues than anything else in the past five years. Meanwhile, less than 1 percent of criminal proceeds laundered via the financial system are seized and frozen by regulatory and law enforcement agencies, a highly problematic result given the significant adverse effects on society¹.

Several international observers and sources confirm that AML/CTF systems are not effective. The *Basel AML Index*² cites poor implementation and poor effectiveness *in anti-*

¹Nyreröd, Theo and Spagnolo (2021) Giancarlo *Money Laundering and Whistleblowing* SNS available at <https://www.sns.se/en/articles/researchers-suggest-introducing-a-european-whistleblower-reward-program-to-combat-money-laundering/>

² The Basel AML Index , a leading index on money-laundering risk which covers over 200 countries, confirm that money-laundering persists on a global scale and is as pervasive as ever, utilizing new and increasingly sophisticated channels and becoming more and more integrated with well-organised It provides risk scores based on data from 17 publicly available sources, covering five domains including quality of:

- (i) AML/CFT framework
- (ii) bribery and corruption
- (iii) financial transparency and standards

money laundering systems as reasons why challenges remain. In addition, jurisdictions consistently score worse for *prevention* than for *enforcement*. Globally, average effectiveness for prevention was 27 percent while the corresponding number for enforcement was 31 percent.

This image is confirmed by the *Wolfsberg Group*, which concludes that AML/CFT risk assessment is currently carried out in response to supervisory expectations, focusing primarily on technical compliance rather than effectiveness³.

There are few signs of improvement. Referring to data from the *Financial Action Task Force*, the Basel Institute on Governance reports an average score for effectiveness across all assessed jurisdictions of only 30 percent. That is two times lower than the average score for technical compliance with FATF Recommendations, which stands at 64 percent⁴.

According to Transparency International's Corruption Perceptions Index, the Nordic countries have historically and consistently ranked among the least corrupt countries in the world⁵. The Nordics have also ranked highly in the Basel AML Index for best AML risk score. Between 2018 and 2021, Sweden demonstrated some minor improvements, moving from 3.75 to 3.36, where zero is low risk and ten high risk. Nordic neighbours Finland, Norway, and Denmark all had similar rankings.

It is worth remembering that legal compliance is not an end in and of itself. Rather, the core question is really one about intent. Being technically compliant is one thing, but properly managing risks to prevent money laundering is another. The question that should be asked, therefore, is whether AML programmes lead to the creation of a solid infrastructure (management system) that actually help prevent money-laundering?

Regulations have developed very quickly, but spokespeople in the industry are still not convinced that they are "fit for purpose". Respondents interviewed for this report also confirm it is hard to keep up with the frequent changes and additions to regulatory requirements, making it difficult to ensure a risk-based approach that incorporates a sufficient level of detail.

(iv) public transparency and accountability, and finally,
(v) legal and political risks.

³ The Wolfsberg Group – Demonstrating Effectiveness (2021) available on https://www.wolfsberg-principles.com/sites/default/files/wb/Wolfsberg%20Group_Demonstrating_%20Effectiveness_JUN21.pdf

⁴ Basel AML Index 2021, p.11., published by the Basel Institute of Governance, available on [Basel_AML_Index_2021_10th Edition.pdf \(baselgovernance.org\)](https://www.baselgovernance.org/Basel_AML_Index_2021_10th_Edition.pdf)

⁵ Transparency International, Corruption Perceptions Index (2021), updated annually: <https://www.transparency.org/en/cpi/2021>

The potential impact of the 5th and 6th Anti-Money Laundering Directives on the effectiveness of AML/CFT programmes remains to be seen. The directives reinforce the obligation to ensure sufficient preventive measures. The legislation on additional offences such as aiding and abetting is also tougher. Moreover, increasing sanction fees from 50 million SEK to a maximum of 10 percent of annual turnover and adding a potential EUR 5 million fine for the board and CEO, offer a strong incentive to comply. These additions are helpful, although they suggest compliance will be carried out to prevent fines, rather than to prevent money-laundering.

With new regulations, supervisory bodies have built capacity and are clearly demonstrating their readiness to sanction non-compliant institutions. These incentives should help push AML to the top of boards' agendas, a conclusion confirmed by this report. However, this does not necessarily translate into effective or efficient AML/CTF management.

When the actual objective of AML efforts is not effectively conveyed and operationalised, financial institutions may find themselves struck with compliance fatigue and fail to see the proper purpose of those efforts. The gap between formal requirement and applied purpose is discussed by respondents in this report, from the perspective of risk management, achieving a risk-based approach, and competence.

4. Analysis – AML State of Play

Contents in the analysis that follows are based on responses given in interviews carried out for this report. Observations and opinions expressed are those of the respondents unless otherwise referenced.

4.1. A look in the rear-view mirror: perspectives from the last five years

“We were still in the Stone Age five years ago. There were no financial institutions able to do a reasonable risk assessment or that understood the workings of money-laundering. Those financial institutions that began working properly with AML and got on top of things were those that were sanctioned by the FSA in 2015. It has taken a long time to understand that AML is about risk management, to handle it, and to report.”
(Senior AML Officer)

Banks and the financial services sector at large have made a quantum leap on AML matters in recent years. The state of play five years ago seems very distant given the giant steps that have been taken since then. With the benefit of hindsight, it is not surprising to see how extensive breaches and non-conformities took place that have since come to light. “Banks where no money laundering issues have been detected or sanctioned in the past have simply been lucky,” said one respondent interviewed for this report.

The same respondent explained that Sweden and the Nordics embarked on the journey towards effective AML very late. Considering how things were around 2016-2017, they said, financial institutions did not even perceive money-laundering as a problem. The starting point in Sweden at the time was five to ten years behind other countries such as the Netherlands or the United Kingdom.

Looking back, it is clear that financial crime discourse at the time was hardly on the radar compared to the situation today. Financial institutions just did not see their own responsibility in relation to that context. Senior management is gradually grasping that AML is part of the criminal value chain, either at the beginning or at the end.

As one respondent put it, AML compliance used to be “lumped together with other issues and ditched on the security manager”. It was not uncommon that staff tasked with money laundering risk assessment were just part-timers. Today, financial institutions have come to realise that effective AML operations require tremendous efforts and investments. AML-departments are populated with full-time dedicated staff, with very specific functions and

responsibilities based on advanced skills. Ideally, these teams are integrated as part of a larger compliance management system. Meanwhile, young talents increasingly seek potential employers based on perceived brand values and environmental and social sustainability, and governance, including taking responsibility for preventing money laundering.

Respondents conclude that Sweden's financial supervisory authorities (FSA) have taken substantial steps in recent years when it comes to enhanced supervision, cross-border cooperation, and tougher sanctions including "naming and shaming", monetary fines, etc.

They all agreed that the upgraded capacity to act demonstrated by the FSA has "changed everything". There is little doubt that the FSA has stepped up efforts to apply the full scope of sanctions and signalled that more must be done.

One effect of these measures is the unprecedented investments in AML that followed. Large banks in Sweden have invested billions of SEK annually to "catch up on fifteen years of neglect", as one respondent commented. Today, financial crime prevention makes up 5 to 6 percent of a large bank's total costs, a level that is almost impossible to compare with the corresponding situation only five years ago.

To illustrate how AML has changed in terms of quantifiable practices, one respondent explained how only a few years ago banks would work with only two risk scenarios. Today it is practice to apply several hundred.

Another effect of supervisory measures is the negative press and loss of trust that follow sanctions. It is impossible to discuss sanctions without considering the impact on brand and credibility. According to respondents, reputational damage is of greater concern than the monetary cost of sanctions.

Moreover, media follows what senior management is doing very closely, down to the level of individual executives and board members. As one respondent framed it, not long ago, nobody cared about a 50 million SEK fine. There was hardly a "glitch in the curve". Now books are written about money-laundering scandals, and journalists line up to interview CEOs, in a way no one could have imagined only a decade ago.

Putting resources to effective use

Within this brief period, the financial sector has started a journey from "ticking the box" exercises designed to simply stay on the right side of the law, towards a risk-based approach integrated with high-level strategic business ambitions. This shift will continue to make a difference ahead.

If sanctions were a game-changer, it was also the signal to start a massive recruitment effort in a labour market where little or no competence and experience could be found.

Most respondents confirmed that funding has not been an issue, it is the availability of skilled recruits that is the challenge.

Organisations have worked hard to staff up and structure their AML-departments, train employees, and are now advancing to the next stage of maturity. While recruiting for AML functions is still a scramble, organisations seem to be moving from merely fixing the headcount to thinking more about competence development and efficiency. In parallel, respondents were also clear about the growing expectations that automation and AI should soon be able to replace simpler manual work and improve the quality in AML processes. “Market players that invest in technology today will be those that excel at risk management in the future,” one respondent commented. With efficient yet customer-oriented processes, AML is becoming a competitive advantage that both traditional and/or neobanks can achieve depending on their ability to resolve the situation using existing or planned infrastructure.

Constant regulatory changes

Regulatory development has been very rapid, and the fact that the EU is working in clear agreement in this area is an advantage. The focus demonstrated on EU-level makes it easier to react fast to new types of criminal behaviour.

But it can also be too fast. Respondents stated that financial institutions are struggling to keep pace with regulatory updates. They describe a constant sprint to, on the one hand, update and implement processes to ensure legal compliance; and to effectively prevent the organisation from being exposed to financial crime on the other. Another complicating factor is the parallel chase to deploy and upgrade technical infrastructure solutions.

Depending on how new regulatory requirements are implemented – as a Sisyphean struggle or as a blessed advancement – respondents were clear that it’s now becoming more prescriptive. The room to manoeuvre and adapt a properly risk-based approach is shrinking.

The tendency will therefore be to lean more heavily on management by detailed directive, which might have the unwanted effect of driving processes to compliance-based check-box management. This is, respondents note, precisely what risk-based organisations are trying to move away from.

One respondent said there is never time to set necessary procedures before new regulations bring additional changes or updates. Banks are forced to focus on implementing bureaucracy, stuck in a constant race to catch up on regulations while financial crime stays one step ahead.

Advantages of smaller organisations

Large and complex organisations move slowly, which means they therefore struggle to update their AML processes fast enough and reach across internal functions and departments. This is where smaller and medium-sized financial institutions might have a comparative advantage. They have practically been more or less forced to adapt smartly and quickly and integrate AML into their operations. Smaller banks have had to take an extremely tactical view, simply because there has been no choice, one respondent suggested. With a more make-do approach maximising limited resources, they have been able to build capabilities and share knowledge across functions effectively.

Joint efforts

A global issue such as financial crime prevention can only be resolved with joint solutions and collective actions. Respondents discussed several perspectives related to the complexity involved, including governance, social responsibility, ethics, and the triple bottom line. Most important is the co-operation between financial intelligence units, supervisory bodies and actors in the financial sector, and the forging of public-private partnerships that are essential to tracing, seizing and confiscating criminal assets.

Several respondents expressed concern about that they saw as shortcomings in how financial intelligence unit communicates and shares information. They felt it should be easier to interact with and get feedback from the financial intelligence unit than is currently the case.

Improvements proposed by the respondents included better information exchange and joint tech development. But there are also tactical implications. While knowledge-sharing and joint efforts are constructive, they can also be sensitive. There are limits to how extensively any organisation is willing to disclose potential or real vulnerabilities.

One respondent referred to how cumbersome the conditions for reporting suspicious activities can be, explaining that it is only possible to include five different subjects in relation to any specific case. To include more than five subjects, a new case must be filed. As a result, the quality of the reporting suffers and prevents the submitting party from giving a complete picture of the situation. If there are twenty individuals involved in one suspected money-laundering case, that means filing four reports. Respondents put this in the context of banks having invested billions, while financial intelligence units and the supervisory authorities have not, leading to the conclusion that the task of crime prevention is placed unfairly on financial institutions even though it is not their core task.

4.2. Why should financial crime prevention be a top priority for financial institutions?

"It's a question of trust; that a bank is sound and clean and makes no mistakes. This is also about money. If criminals cannot access their funds, it breaks the chain...All reports submitted by banks need to be properly received, however the obligation to report [suspicious activities] becomes partly meaningless when there is no corresponding capacity on the receiving end of the authorities concerned." (Senior AML Officer)

The bigger issue

Money laundering is increasingly discussed in relation to corporate social responsibility, including environmental, social, and governance (ESG) matters. Financial institutions understand that they are conduits for organised crime which relates directly to societal problems and a long list of sustainability challenges.

Respondents were clear that it is they themselves i.e., the whole financial services sector, together, that makes up the playing field for criminal actors. One respondent said, "imagine being a bank that does not take social responsibility". This bigger issue has also become an employer branding and investor issue, further expanding the scope of risks that financial institutions need to control when it comes to AML efforts.

Trusted and reputed

"When you are perceived as safe and secure, you become more attractive to customers and investors. This always needs to be connected with good business acumen." (Senior AML Officer)

Successful AML means being a responsible company that wants to do the right thing. Managing risk also means safeguarding trust as a critical asset and being able to protect brand value. Lawyers working with AML naturally focus on compliance by trade. But defamation by association, or a mere suspicion of a breach leaking to the public is enough to cause real damage. It does not have to involve a proven regulatory breach. Becoming associated with money laundering can also negatively impact customer loyalty, respondents said.

The international statistic that only 1% of all money-laundering is caught is without doubt known by most by now. In this context, one respondent commented that AML should remain a top priority because "nobody with a clean conscience can say that there is no money laundering in their organisation". Everyone wants to communicate convincingly and

honestly around risk scope and risk appetite. An honest assessment of the current reality, the same respondent suggested, is that “all that can possibly be done is being done. It is partly about preventing financial crime, partly about regulatory compliance. An organisation needs to focus on both to be successful”.

Dealing with contradictions

Discussions with respondents suggest that there is a split vision with regards to maturity and mindset. On the one hand, some respondents look back at the rapid development of recent years and conclude that there is a new mindset, with a much better understanding of the underlying reasons and rationale for why financial institutions need to address AML. At the same time, the findings of AML departments are still regarded as deal-breakers.

This observation might be described as a case of corporate cognitive dissonance: on the one hand, there is full support internally for achieving AML compliance; on the other, the prospect of having to reject certain customers and lose some business as a result of those compliance efforts remains unpalatable. Respondents confirmed that risk appetite is clearly a board level issue, and to deal with this dissociation, senior management needs to do much more internal communication and internal marketing.

Prioritisation is also about having the right information. With more data at hand as well as data-driven processes, organisations should be better positioned in the future to address AML. One respondent expressed confidence that data – including both static customer data and dynamic behavioural data – will contribute to finding the right perspective and bring about smarter solutions.

Over and above sanctions, how financial intelligence units and FSAs function can also have an impact, although secondary. Depending on perceptions of how well these regulatory bodies work, financial institutions will be more or less encouraged to prioritise AML. If they feel there is little or no effort made by FIUs, there will be less bandwidth internally to build support for focusing on AML efforts. Respondents felt that the FIU and other supervisory authorities need to ramp up their capabilities to mirror the tremendous efforts and investments made by financial institutions. Should this be perceived as a fairer balance than it currently is, financial institutions would feel much more incentivized to stretch further and do even more.

4.3. What does it take to make financial crime prevention a senior management and board level issue?

“It’s not about the literal interpretation of the of law; we need to understand how to apply the law in an extremely complex world and sector. For example, when an organisation is unable to establish how many high-risk customers it has, it is an indication of something beyond a legal issue.” (Senior AML Officer)

Catch-22

Financial crime is already a top priority, confirmed by most respondents, but that does not mean the C-suite knows what to do. Respondents confirm that reputational risk is indeed a driving force, however it is the threat of sanctions that keeps the board attentive. AML is now more a question of translating that attention and concern into a deeper understanding of how to ensure that AML programmes operate efficiently.

Respondents commented that AML must be on the agenda “all the time” to continuously develop competence as needed. It requires organisational structure and capacity. “It’s wrong to believe that we can sanction away problems, and that better governance structures are needed to give people prerequisites for doing the right thing,” said one respondent. More training and competence development is also needed.

Respondents confirmed the important step that risks cannot be effectively addressed without knowing the root cause. “Knowing the unknown” is obviously a classic dilemma. Failing in that insight, the alternative is to “pay and pray”, allocating substantial resources that ultimately result in limited output.

Boards must also see to it that relevant questions about risk are asked routinely to ensure that risk information is requested pro-actively. Respondents also argued that AML is not necessarily a legal competence issue, but an interdisciplinary issue. If senior management and the board at any given point in time do not know what their top financial crime risks are, this is not a legal problem but something else, suggesting perhaps poor governance. In terms of how this can be resolved, discussions resort back to awareness, hybrid training solutions and ensuring systematic risk assessment where the right questions are asked.

Tone at the top

The tone at the top, or genuine willingness, is well-worn wording in this context, but nevertheless warrants more attention and discussions on how to achieve it. Respondents confirm the importance of the tone at the top, saying it is decisive and influences the whole

organisation. There are plenty of examples available when looking at financial crime scandals in recent years. If something is not obligated by law, as one respondent said, it will not get the same attention even if the bank wants to be a good corporate citizen⁶.

Personal responsibility and especially the potential threat of prosecution drives genuine willingness. With it comes a sense of urgency to ensure effective risk management. It could also be the reverse, although perhaps more challenging to achieve: provided there is a proper understanding of risks and risk exposure, the willingness to manage them will grow.

Also, in this context, echoing the former questions, respondents discussed that communication with financial intelligence units and supervisory authorities is very important as a validation that the organisation is operating and reporting adequately. More and better feedback and communication from government bodies is needed for both senior management and boards, to help them understand how well they are doing, and to support the organisations in their continued efforts. One respondent expressed this saying that the “Financial Supervisory Authority does not provide much clarity, but are rather non-communicative, and would really need to take action to provide guidance and make things relatable”. Better information would help senior management to better understand their priorities. Respondents also said that the sector can and wants to do more but is partly hindered by legislation that does not allow information sharing and is sometimes contradictory. Because of this, respondents feel financial crime prevention ends up being both unsatisfactory and unsatisfying.

4.4. Current challenges in risk management

Competence

Discussions about risk management challenges revolved around competence as the most strategically important issue. This applied from the board down to individual customer managers. Media reporting, legal trials, and ESG are attention grabbers, and can lead to the perfunctory use of buzz words and hasty quick fixes. Organisations need to make sure they

⁶ Authors note, that with the updated Guidelines on internal governance under Directive (EBA/GL/2021/05 2 July 2021) from the European Banking Authority, noting especially point 98 in *Title IV- Risk Culture and Business Conduct*, this is obviously a regulatory requirement.

can back their communication with risk management competence and substance. Market stakeholders talk about “green-washing” with regards to environmental issues, and “white-washing” with regards to social responsibility. There is a difference between being strategic and prioritising the right questions and, as one respondent put it, “carelessly resorting to buzzwords”. Competence is a prerequisite for making proper risk-based decisions and requires more training that is properly balanced between both banking experience and risk management. It is important that financial institutions avoid resorting to phraseology.

Risk-based approach

There is still a divide between organisations that build their AML processes based primarily on literal compliance and abiding by the letter of the law, and those that firstly focus on the essence of achieving a risk-based approach. For sure, the former can result in the latter, but respondents admitted the mindset for transposing the letter of the law into an effective risk-based approach is often missing.

Risk management departments are rarely integrated with functions in charge of financial crime prevention and other risks related to that area. Organisations need to master a holistic and risk-based approach that can break down silos and lead to better integration. This can only be achieved through a better understanding of what constitutes a risk.

Functions are struggling to establish the correlation between customer risk modelling and setting the right parameters that allow them to derive value from their customer risk modelling. On paper, customer risk classification is the most important task. Respondents nevertheless admitted they do not believe many organisations have as much use for KYC as they could have. It was suggested that ratio between the KYC analysis and what is later detected as a problem might be as low as 1 to 5.

Discussing country risk, one respondent commented that it is too easy to classify a foreign transaction as high risk, emphasizing that it is important to also understand why certain countries should be regarded as high risk, and what it is that drives that risk. “Looking at Malta as one specific jurisdiction, we understand. If we look at China, we don’t.” This is part of the challenge and explanation for why risk management has not been very effective. The understanding of risks has been – and still is – too blunt. And addressing this situation could be the easiest deficiency to correct. Other processes will follow, given that monitoring is based on risk assessment. Moreover, it is clearly a challenge to make all systems, from policies to procedures to customer responsibility, align and function together.

As noted above, respondents also discussed the challenges with regards to ensuring a risk-based approach in the context of new EU regulations. The more detailed and prescriptive regulations become, the more it is perceived as comparable to US legislation, which reduces the space available for proper risk-based work. The need to produce such large

volumes of documentation according to set standards risks drowning out what really matters. It can lead to a situation whereby AML-staff might end up having to mark relevant text in bold to show and understand the parts that are truly important.

As AML processes mature, organisations are seeing the wider business value and utility of AML. But the difficult reality of having to take decisions to shut down accounts and manage those processes remains inescapable. This is not always a straightforward process. Respondents noted that it can be difficult to understand which laws that apply to a specific risk and situation. One example is fake documents connected to housing mortgage applications which demonstrates how difficult it is to close existing accounts. Once the customer is in, they are in. Tackling this challenge requires greater focus on proactive prevention. It is worth noting that, despite the European Banking Authority's recent opinion on de-risking⁷, none of the respondents mentioned the issue of de-risking in interviews for this report.

Value from KYC

Respondents discussed the KYC process (Customer Due Diligence) with a sense of both doubt and hopefulness. Some questioned if it is even possible to use KYC results; others doubted whether any value at all could be derived from customer risk classification. Rather than to rely on KYC outcomes, respondents explained, it might be better to look at customer behavioural patterns over time, a view that could be seen as somewhat radical. The more hopeful respondents talked about KYC in terms of an untapped source of business intelligence that should be much better leveraged to create value for both the organisation and individual customers.

KYC as a process is the foundation for a customer-focused business and is a valuable yet overlooked source business intelligence. However, realising these synergies and reaping business benefits of KYC feels far away. Rather than being viewed as creating value, the KYC process is seen as "disturbing" according to respondents.

Whether the KYC process creates value – or the reverse – depends to a large extent on how well customer interaction and customer communication is managed. How questions are asked, including what words and expressions are used is one aspect. Another determining factor is or not whether a risk-based approach is in place that can differentiate between different customer categories and the corresponding information gathering requirements.

⁷ [EBA Opinion and annexed report on de-risking.pdf \(europa.eu\)](#)

One respondent explained that bank staff would be greatly helped by knowing better what questions to ask to which customers, and not just asking the same questions to everyone. When it comes to PEP, for example, not simply asking, “Are you a PEP?”, but rather “What type of business are you in?”. It’s all about being able to ask better, more nuanced questions, as well as knowing when to ask more or fewer questions, and have a better understanding of the few questions that can reveal vital information.

Legacy structures and tech development

Respondents were quite aligned in their views about the possible applications of IT and AI to resolve a range of AML issues. Several also observed that the financial sector sorely needs new tech development.

Overall, respondents felt Sweden was on the forefront of tech development. However, AML risk competence is needed to build the required systems in future. Systems should be built around risk, rather than regulations, respondents confirmed. Existing challenges generally involve getting reliable information at the customer on-boarding stage and being able to verify data points.

It is easy to say organisations need to invest in technology. However, accessing reliable data is arguably even more critical to preventing money-laundering. Given the amount of data required, accessing reliable data can only be tech driven. Financial institutions today are still working with large departments, or as one respondent put it – “factories” – of investigators. Transaction monitoring systems will require automation and AI in future.

While technology development is advancing at extreme speed, so are new regulatory requirements and directives. Moreover, the market is seeing rapidly growing transaction volumes. Organisations need to manage these parallel trends simultaneously, both strategically and tactically.

According to the respondents, obsolete technical solutions can explain the prevalence of legacy data, which is a root cause of the resource-intensive headaches associated with so-called false positives, i.e. when monitoring systems flag transactions that are not actually suspicious. Moving forward, respondents said, requires new risk assessment tools involving the whole organisation that can in turn create the necessary synergies.

Financial institutions will have to evaluate what they are capable of while at the same time consistently ensuring a risk-based approach. New tools are needed with APIs that can collect information focusing on the customer and what can be identified as non-conforming behaviour.

Discussing tech development as one of the challenges in risk management, respondents also believed law makers and regulators could do more, referring to unique beneficiary

owner registers and the ability to provide access through APIs and to verify data. One respondent referred to the example of Singapore, where financial institutions can share information on an anonymous basis. From an EU perspective, that could translate into joint UBO registers⁸.

4.5. AML risk management: Lessons learned and recommendations

“Dare to adjust risks downwards as well, to be confident in doing less where possible. Focus should always be on greater risks, but sometimes one should also look at the opposite, to reduce risks.” (Senior AML Officer)

“One lesson learned is that one cannot do too much in this domain. The hard part is to do the right things. A lot of systems are not performing, but then things just keep moving along. With regards to systems, I believe we are still on a level from 2015.” (Senior AML Officer)

Focus on material risks

Looking ahead, respondents emphasised risk management, a holistic approach, tech and IT systems, the role of the board of directors, awareness and willingness, as well as information sharing and interaction with supervisory authorities and other government bodies.

Regardless of the aspect or issue being discussed, respondents inevitably returned to risk management. A strong recommendation is to continuously work on risk assessment, risk scenarios, and customer focus, which is at the core of a successful risk-based approach.

Respondents emphasized that risk management must be an integrated part of business operations, from the board level down to the individual compliance functions and the first line of defence. Resources should be allocated to risks that are material, which ultimately becomes a question of resource utilisation and return on investment.

When discussing the expectations of a risk-based approach and getting results from efforts in multiple areas, respondents admit that nobody can be best in all classes. It is simply unaffordable, as one respondent commented. Getting spread too thinly, with efforts sprinkled everywhere will not produce quality results. It’s therefore up to each individual

⁸ Authors note that it will, i.e. plans for connected transparency register.

organisation to find the appropriate level of investment in line with the ambitions and risk appetite set by the board.

One respondent suggested that, as AML programmes become more sophisticated, organisations should have the self-assurance of data quality to ultimately adjust risks downwards when warranted. Focus should always be on the greatest risks, but sometimes one should also look at the opposite: to do less where possible to allow resources to be freed up and applied in other areas. One respondent confirmed this approach, wishing to see [more] scenarios where customers are reclassified as lower risks, based on the position that there must be customer segments where low risk is standard and where organisations should have the confidence to act accordingly. This becomes a matter of maturity in applying a risk-based approach, which then provides the confidence to reclassify a customer as lower risk, assuming the supporting evidence exists to do so.

Furnish the board with competence

Organisations can be hit by “compliance fatigue”. AML is a never-ending effort, and the challenge is to never stop updating, adapting, and communicating around those efforts’ purpose, so that the business rationale for AML stays top of mind. The willingness to stretch beyond compliance by law, is contingent on adequate awareness and “understanding at the top” which is the foundation for the “tone at the top” that has a critical role in shaping the outlook of the organisation and its employees. Without it, as one respondent commented, it is basically game over.

A few years ago, financial institutions were scrambling to recruit people to their newly established AML-departments. Apart from a few and relatively unexperienced hires, the market was literally void of AML competence at the time. The mismatch between supply and demand may now be happening at board level. For financial institutions to ensure both effective and efficient risk management with all the prerequisites that it entails, boards need to have relevant subject matter expertise close at hand. At present, one respondent argued, it’s very difficult to find this type of competence at the board level or among aspiring board professionals.

Simply put, boards need someone with the knowledge and awareness to pose relevant questions and make sure that controls are working properly in an organisation across all types of risks.

The responsibility of the board has increased substantially given the new regulations from the European Banking Authority (EBA). One respondent discussed this perspective, explaining that organisations need to have sufficiently staffed control functions, which also suggests that board members at banks need to be incredibly operational in the current environment. Considering the limited availability of the desired competence, potential

conflicts of interest and the number of board engagements one individual director can reasonably have, this is a challenge.

Take the holistic approach

Throughout the interviews, respondents arrived at several common recommendations. One is that organisations need consistently focus on ensuring a risk-based approach. The other is to strive for a holistic and cyclical approach, which requires the ability to work effectively across functions and break down silos. AML risk must be incorporated in the overall risk management of any given organisation. It also involves planning for review and adjusting risks according to monitoring outputs.

Deal with purpose and sunk costs

Respondents expressed a sense of urgency about wanting to replace manual and less qualified work with new tech solutions. At the same time, there is concern about the incredible speed with which technology is developing and emerging on the market. It becomes a constant game of catch-up.

Strategy and investment decisions become even more crucial and sensitive, and there can be a lot of prestige involved. Organisations with outdated systems or those that fail to meet current requirements may have to have the courage to admit that sometimes decisions must be reversed and choices recognised as unsuitable for current business needs, even if the decision might have been right at the time. As dealing with sunk costs can involve a lot of prestige, it is often a question of leadership more than anything else. One respondent remarked that many organisations have incredible IT debts yet remain ineffective because of expensive decisions and vested interests, lacking the courage to re-examine themselves to do what is best for the bank. In a situation where management has invested millions in things that do not provide a solution going forward, the board and senior management must not allow the organisation to get stuck. It can be painful, but nevertheless worthwhile for organisations to scrutinize.

Share information

Effective AML requires the exchange of information between authorities and the financial sector. Respondents recommended that the Swedish Anti-Money Laundering Intelligence Taskforce (SAMLIT), should include additional members as more banks want to join and share information through this platform. Information-sharing should be a level playing field. All players with a banking license should share the same information.

5. Rating questions

In the following five questions, respondents were asked to give a rating between one and ten. In a few cases, respondents gave a half-digit rating, for example 3.5. In our analysis, even numbers have been truncated downwards, and odd numbers upwards.

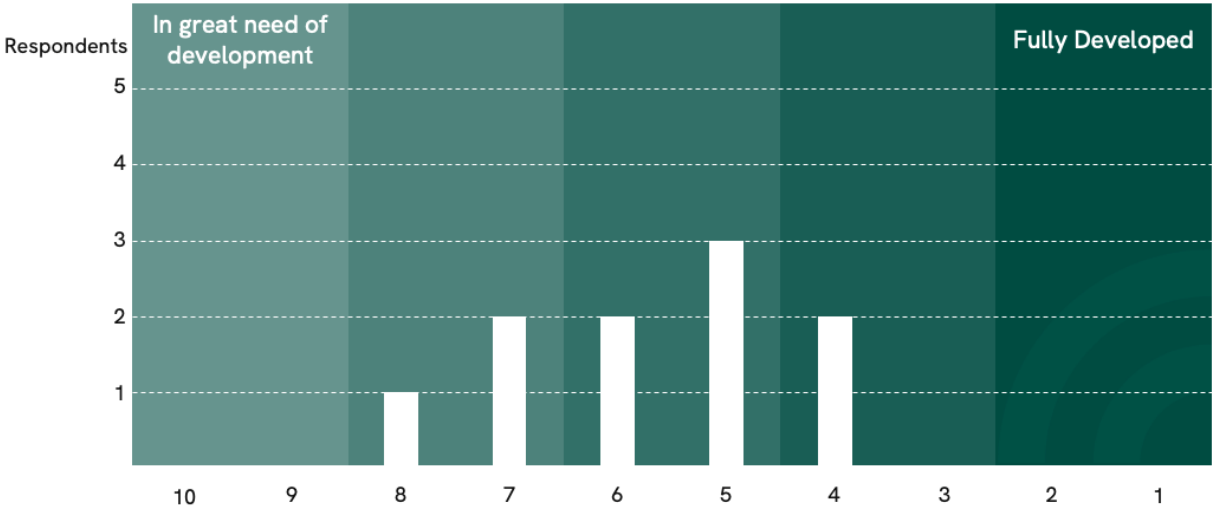
5.1. Setting KPIs for an organisation’s overall AML

Question: *What are your thoughts on setting Key Performance Indicators (KPIs) for an organisation’s overall AML? Is this an area of work that still needs a lot of development or do you regard it as more or less fully developed?*

Distribution: 3.5 – 8

Average score: 5.6

1= Fully developed/excellent; 10= Poor, in great need of development



Selected quotes by respondents in relation to this question

“It’s one thing to set KPIs; it’s another to deliver on those KPIs. It’s easier to set a qualitative risk appetite, and you realise this quickly once you have a good risk management process in place. But when addressing a quantitative risk appetite, you realise that you won’t be able to define it that clearly. You need to define how large a share of the risk you are prepared to accept.”

∞

“Should you decide on zero tolerance for money laundering with regards to cash, you need to assess every single deposit. Should you set the limit to 40,000 SEK, everything below will slip through. That is what is totally undeveloped, and a reason why an organisation’s actual risk appetite can end up being a bit ad hoc and random.”

∞

“You always need to accept some money laundering risk, otherwise the bank simply needs to be closed down. It’s not realistic otherwise.”

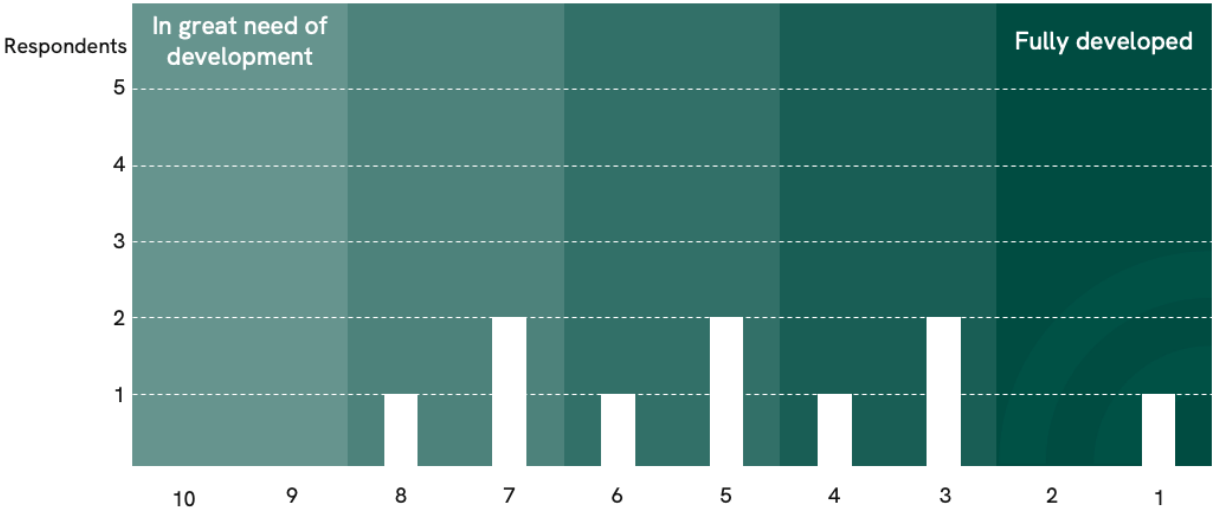
5.2. Defining an organisation’s risk appetite for AML

Question: *What are your thoughts on the issue of defining an organisation’s risk appetite for AML? Is this an area of work that still needs a lot of development or do you regard it as more or less fully developed?*

Distribution: 1 - 8

Average score: 4.9

1= Fully developed/excellent; 10= Poor, in great need of development



Selected quotes by respondents in relation to this question

“For most people, it’s clear a general risk assessment must be carried out. I don’t like the word risk appetite in conjunction with AML. I would rather talk about risk tolerance. One

cannot have an appetite for a little bit of AML risk. We should talk about risk tolerance instead, what is manageable or not."

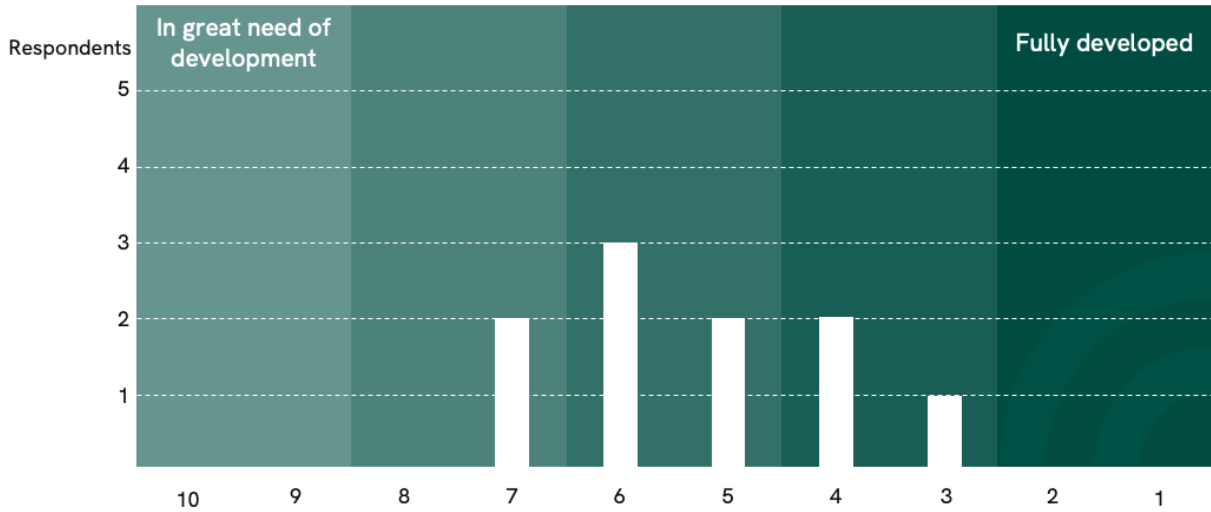
5.3. Setting relevant Key Risk Indicators (KRI)

Question: *What are your thoughts on the issue setting relevant Key Risk Indicators? Is this an area of work that still needs a lot of development or do you regard it as more or less fully developed?*

Distribution: 3 - 7

Average score: 5.3

1= Fully developed/excellent; 10= Poor, in great need of development



Selected quotes by respondents in relation to this question

"It might be the case that KRIs have been set but that they don't reflect or aren't based on the risk appetite. This has to do with KPIs and concerns operational, non-financial risk, which makes it difficult to find good statistics. If you are struggling to find KPIs it is difficult to find KRIs."

∞

"The number of reported frauds is an example of a KPI, but at the same time it could be a KRI that points in several directions."

∞

“The organisation can file a report, including the number of suspicious activities, however when it comes to specifically setting KRIs, I believe we base this on our appetite, so that should be a seven [on the scale above]. However, when it comes to reporting, then that should be a three.”

∞

“It should be reviewed when there is an increase. The process is underdeveloped when it comes to what happens when we come close to a limit and what that means in terms of providing more resources and decision-making.”

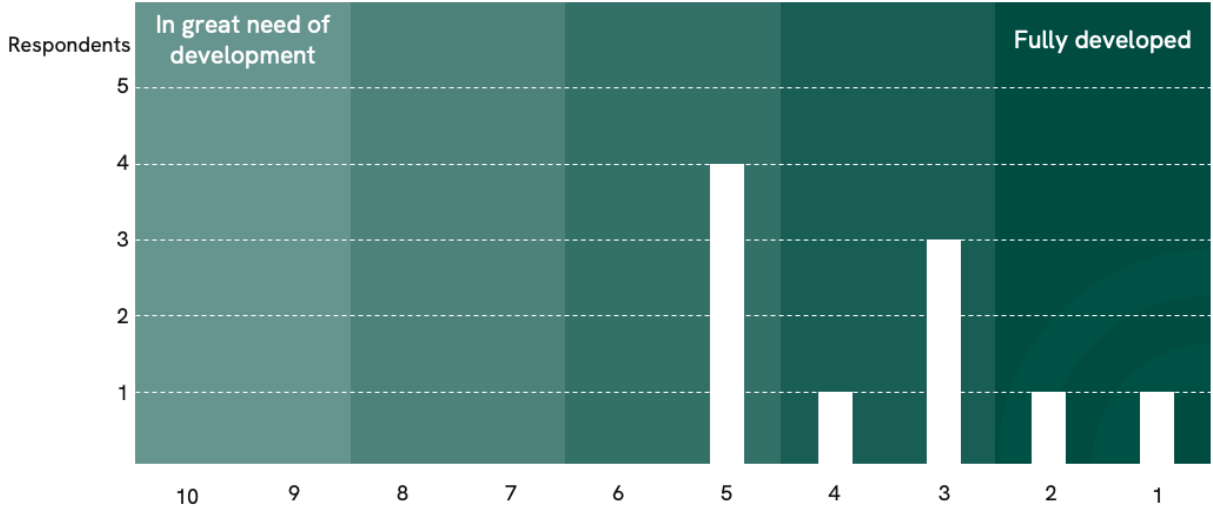
5.4. Implementing effective and efficient PEP/sanction-screening models

Question: *What are your thoughts on the issue of implementing effective and efficient PEP/sanction-screening models? Is this an area of work that still needs a lot of development or do you regard it as more or less fully developed?*

Distribution: 1 - 5

Average score: 3.6

1= Fully developed/excellent; 10= Poor, in great need of development



Selected quotes by respondents in relation to this question

“Most organisations have that, but the different lists...the question is how good the lists are.”

“We report how many PEPs or high-risk customers have been identified, linked to the annual reporting. But we have not set a limit, for instance, that the organisation should have X percent of one or the other.”

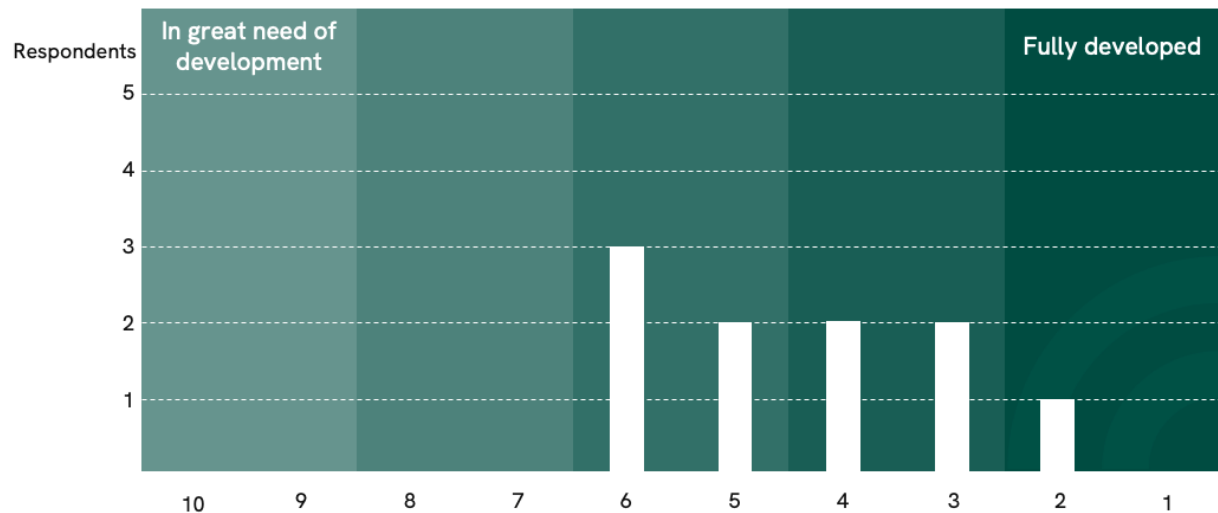
5.5. Measuring efficiency of transaction monitoring

Question: *What are your thoughts on the issue of measuring efficiency of transaction monitoring? Is this an area of work that still needs a lot of development or do you regard it as more or less fully developed?*

Distribution: 2 – 6.5

Average score: 4.5

1= Fully developed/excellent; 10= Poor, in great need of development



Selected quotes by respondents in relation to this question

“All systems are built for banks and are not suited for non-banking operations. This is something we need to work with constantly. Customers can’t be allowed to establish what the limits are themselves in order to abuse the system.”

“Given the enormous transaction volume, we need to be able to catch the worst cases and have an organisation that’s able to manage this. There are absurd headcounts that work with these issues, it is resource-*demanding*, and we need better systems generally. The market is immature, and some banks are trying to develop their own solutions. It’s a combination of competence and systems. Today you can get a diploma as an AML specialist from the Stockholm School of Economics, but much more is needed. It’s about behavioural science.”

∞

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