

The Wolfsberg Group – Demonstrating Effectiveness

This Paper builds on the Wolfsberg Group’s (the Group’s) prior work by suggesting ways in which a Financial Institution (FI) can assess risk in defined priority areas and demonstrate the effectiveness of its Anti-Money Laundering/Combating Terrorist Financing (AML/CTF) programme. In December 2019, the Group published a Statement on Effectiveness that outlined what it believes are the key elements of an effective AML/CTF programme (The Wolfsberg Factors):¹

1. Complying with AML/CTF laws and regulations
2. Providing highly useful information to relevant government agencies in defined priority areas²
3. Establishing a reasonable and risk-based set of controls to mitigate the risks of an FI being used to facilitate illicit activity³

In August 2020, the Group published a follow-up Statement on Developing an Effective AML/CTF Programme.⁴ In that Statement, the Group outlined the following suggested steps for FIs to evolve their AML/CTF programmes to focus more on effective outcomes:

1. Assess Risk in Defined Priority Areas
2. Implement/Enhance Controls
3. Prioritise Resources
4. Engage with Law Enforcement
5. Demonstrate AML/CTF Programme Effectiveness

In this paper, we discuss assessing priorities and demonstrating effectiveness and how the Wolfsberg Factors can serve as a useful framework for doing both. The Group believes designing, assessing, and measuring AML/CTF programmes based on performance against these defined outcomes would not only enable FIs to detect and deter criminal activity better, but also improve the effectiveness of the system to combat money laundering and terrorist financing overall.

Assessing Risk in Defined Priority Areas

The Financial Action Task Force (FATF) requires countries “to identify, assess and understand the money laundering and terrorist financing risks they are exposed to. Once these risks are properly understood, countries will be able to implement anti-money laundering and counter terrorist financing measures that mitigate these risks.”⁵ This risk-based approach is central to the effective implementation of the FATF standards.⁶ Similarly, we believe the starting point for an effective AML/CTF programme should be an understanding of the priority risks identified by countries or supra-national bodies in those assessments, and the applicability of those risks to the FI.

Today, however, most FIs do not focus their AML/CTF risk assessments on government priorities. Instead, and largely in response to supervisory expectations, AML/CTF risk assessments are focused on technical compliance

¹ The Wolfsberg Group (2019), *Statement on Effectiveness – Making AML/CTF Programmes More Effective*, www.wolfsberg-principles.com/sites/default/files/wb/pdfs/Effectiveness%201%20pager%20Wolfsberg%20Group%202019%20FINAL_Publication.pdf.

² Information as defined and aligned to nationally defined financial crime prevention priorities, most importantly those set by law enforcement or prosecuting authorities.

³ In September 2020, the U.S. Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN) proposed a similar definition in an Advanced Notice of Proposed Rulemaking. See www.federalregister.gov/documents/2020/09/17/2020-20527/anti-money-laundering-program-effectiveness.

⁴ The Wolfsberg Group (2020), *Developing an Effective AML/CTF Programme*, www.wolfsberg-principles.com/sites/default/files/wb/Wolfsberg%20Effective%20Financial%20Crimes%20Programme%20-%20August2020%20%28FFP%29.pdf.

⁵ FATF (2021), *Money laundering and terrorist financing risks*, FATF, Paris, <https://www.fatf-gafi.org/publications/methodsandtrends/documents/ml-tf-risks.html>.

⁶ *Id.*

with requirements rather than the effectiveness of the FI's efforts to prevent and detect financial crime. This exercise typically culminates in an enterprise-wide risk assessment which tends to be very long, complex, and focused on data, documentation, and process rather than outcomes.⁷

In order to be effective, assessing risk in priority areas needs to be done differently. FIs should focus on threats related to specifically defined national or supra-national priorities. This process should be more agile and less prescriptive than the enterprise-wide risk assessment as it is currently undertaken. Where specifically defined priorities do not exist, FIs can leverage priorities described in the jurisdiction's National Risk Assessment, or equivalent publication, as defined priority areas. In either case, the more detailed information that is shared, by governments with FIs, related to these threats, whether publicly or privately, the better the FI will be able to evaluate, mitigate, and potentially provide useful information related to these threats to law enforcement. The Group intends to discuss threat assessments in more detail in an upcoming paper.

Evaluating and Demonstrating Effectiveness

The Group believes that the Wolfsberg Factors provide a useful framework for evaluating the effectiveness of an FI's controls in defined priority areas and for demonstrating the effectiveness of its AML/CTF programme overall. Where an FI can demonstrate, for a specific threat or for the AML/CTF programme overall, that it has complied with applicable AML/CTF laws and regulations, designed its programme to provide highly useful information to government authorities, and implemented a reasonable and risk-based set of controls to prevent and detect financial crime, this should be considered as strong evidence of the FI's effectiveness.

1. Complying with AML/CTF Laws and Regulations

FIs must comply with AML/CTF laws and regulations. This is the foundation for AML/CTF programmes. In order to do this, FIs must understand the AML/CTF laws and regulations for each applicable jurisdiction, or supra-national authority, and implement reasonably designed processes to comply with these requirements, as well as controls and reporting to demonstrate how they comply with the relevant law or regulation. Supervisors, for their part, should clearly differentiate between legal or regulatory requirements that must be met and other areas where FIs are permitted to take a risk-based approach. Today, FIs spend significant time and resources on activities that are considered "expectations" of an AML/CTF programme but are not required by law or regulation. These "expectations" are sometimes written in non-binding guidance, sometimes unwritten, or can be a reflection of the views of an individual examiner or auditor. However, unless these activities lead to highly useful information for government authorities or help the FI materially prevent, detect, or deter actual crime, these "expectations" are often counterproductive to an effective AML/CTF programme.

2. Providing Highly Useful Information to Government Authorities in Priority Areas

The extent to which governments define priorities and provide feedback to FIs on reporting will vary by jurisdiction. Likewise, the risks related to published priority areas will vary by FI, depending on its size, business model and geographic scope. These factors will have an impact both on the type and quantity of highly useful information

⁷ In 2015, the Group published "The Wolfsberg Frequently Asked Questions on Risk Assessments for Money Laundering, Sanctions and Bribery & Corruption." Those Frequently Asked Questions (FAQs) were largely focused on the enterprise-wide risk assessment process. The Group is currently reviewing those FAQs and plans to reaffirm or update the FAQs in light of the Group's effectiveness work.

that the FI provides to law enforcement. Therefore, demonstrating and assessing effectiveness in providing highly useful information to government authorities will necessarily vary by FI.

For some FIs, it may be helpful to track engagement with, and information provided to, government authorities. The metrics and programme attributes described below could be used internally by an FI to measure its effectiveness, or externally to demonstrate to supervisors that its programme is reasonably designed to provide highly useful information. The metrics focus on the quality, not the quantity, of reporting. The best indicator of quality is direct feedback from government authorities and, as discussed further in the next section, how that feedback influences enhancements or improvements to the FI's control framework. Where feedback is limited or unavailable, FIs could consider factors like the complexity of the investigation, the identification of network activity, or reporting in identified priority areas, as indicators of quality. While these indicators are not perfect, the Group's experience, and general feedback from government authorities, suggests that the examples proposed below demonstrate the FI's commitment to providing highly useful information to law enforcement.

The examples provided, however, are neither an exhaustive list nor intended to imply that there be a requirement to track these or any other particular type of information to demonstrate effectiveness. Some of the examples may not be applicable to certain FIs based on their size, business model, risk profile, or available government feedback in the jurisdictions where they operate. A smaller FI with a lower risk profile, for example, could have an effective AML/CFT programme even if it has not filed any Suspicious Transaction Reports/Suspicious Activity Reports (STR/SAR), for as long as the FI has demonstrated an understanding of its financial crime risk and implemented a reasonably designed programme based on its risk profile. For these reasons, the metrics should not be used as a basis to compare one FI to another.

Law Enforcement and Government Engagement

- Use of intelligence from law enforcement and relevant government authorities, including Financial Intelligence Unit communications
- Participation in public-private partnerships
- Results from engagement in public-private partnerships (i.e., government action following tactical information sharing or work on strategic and policy initiatives)
- Engagement with law enforcement and relevant government authorities on priority areas, including sharing information and typologies
- Recognition/feedback from law enforcement and relevant government authorities
- High quality and timely responses to requests from law enforcement and relevant government authorities
- Analysis of requests from law enforcement and relevant government authorities
- Number of relationships/accounts maintained at the request of law enforcement (sometimes referred to as "Keep Open Requests")

Suspicious Transaction Reports (STRs)/Suspicious Activity Reports (SARs)

- STRs/SARs filed in priority areas aligned to nationally defined/published financial crime priorities, including those set by law enforcement
- STRs/SARs that identify networks of interconnected suspicious activity typically involving several parties
- STRs/SARs filed following a complex investigation by the FI
- Percentage of STRs/SARs filed that result in follow-up enquiries from law enforcement or government authorities

- Percentage of STRs/SARs in priority areas where the FI has received positive law enforcement or government feedback
- STRs/SARs where government action was later taken (e.g., the suspect was later charged with or convicted of a crime, asset seizure, etc.)
- STRs/SARs filed following information sharing from the government
- STRs/SARs filed following information sharing from other FIs, where legally permissible

3. Reasonable and Risk-Based Controls to Detect, Prevent or Deter Financial Crime

As financial crime risks vary by FI, so too will the risk-based controls necessary to mitigate those risks. Risk-based controls should be reasonably designed to both prevent the FI from being used to facilitate illicit activity, as well as to detect and report potential illicit activity. These controls should include, but may not be limited to, AML/CTF policies and procedures, risk assessments, collection of customer due diligence (CDD), enhanced due diligence (EDD) requirements where appropriate, oversight of the business, governance processes, transaction monitoring, economic sanctions screening, a system for employees to refer potentially suspicious activity, and AML/CTF training. An FI may also demonstrate effectiveness by applying lessons learned from government engagement or other priorities-focused work towards the development of new or enhanced controls to detect, prevent or deter financial crime.

While these, and indeed other, controls are well known, today auditors, consultants and supervisors tend to focus their assessment of these controls almost exclusively on their technical implementation and execution. In a regime focused on effectiveness, supervisors and FIs would instead focus on the practical element of whether the controls are making a material difference in helping the FI, and the jurisdictions in which it operates, mitigate its risks and address defined AML/CTF priorities. In other words, as the FATF has emphasised, effectiveness should be judged on outcomes rather than process.⁸ Therefore, in order to demonstrate effective controls, FIs should be prepared to explain to their supervisors how their controls actually mitigate risk and/or provide highly useful information to government authorities.

Not only should the controls mitigate risk, they should also be risk-based. This means focusing controls on areas that present a higher risk to the FI. In discussing risk-based supervision, the FATF has said “[t]here also needs to be a recognition that AML/CTF related weaknesses in areas of lower [Money Laundering/Terrorist Financing] risk may go undetected by supervisors in the application of risk-based supervision ...”⁹ The same is true for an FI’s AML/CTF programme. Where an FI has reasonably focused on higher risk areas in line with its assessment of the threats it faces, an undetected weakness in a lower risk area is not by default an indication of programme failure, but rather a natural extension of the implementation of a risk-based approach.

One final consideration related to the effective implementation of a set of risk-based controls should be the time and resources devoted to such efforts, relative to the risk mitigation. Where a control requires significant time and/or resources for minimal risk mitigation, FIs should consider changing or eliminating the control altogether and reallocating those resources to those with demonstrably more effective outcomes. In other words, it is entirely normal for an FI to decommission ineffective and inefficient controls. The opportunity cost of failing to change or

⁸ See FATF (2021), *Guidance for applying a Risk-Based Approach to Supervision*, FATF, Paris, www.fatf-gafi.org/publications/documents/Guidance-RBA-Supervision.html at ¶ 18 (“The FATF focuses on outcomes rather than process.”).

⁹ *Id.* At ¶ 81.

eliminate an ineffective or inefficient control should be a part of an FI's overall assessment of its risk-based controls. The Group plans to address resource prioritisation in more detail in an upcoming paper.

Conclusion

Ultimately, each FI should be able to demonstrate effectiveness by telling its unique story, based on its risks and corresponding AML/CTF programme. An FI's effectiveness, as it relates to designated priorities or the AML/CTF programme overall, should be measured based on its compliance with law and regulations, how it is designed to provide highly useful information to government authorities in defined priority areas, and how the FI builds and maintains a reasonable and risk-based set of controls to mitigate the risks of the FI being used to facilitate illicit activity. The Group believes designing, assessing, and measuring AML/CTF programmes based on performance against these defined outcomes will help to achieve the FATFs goal of creating a more effective system to combat money laundering and terrorist financing, while at the same time reducing friction on legitimate customers and supporting governments in achieving their financial inclusion objectives.