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Monitoring of customer transactions as an essential component of a reasonably designed risk-based approach in CDD

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Gratifying AML regulators appetite for customer due diligence (CDD) has never been easy because good data is not always abundant. But we're entering a new dynamic now. Now we need have a risk-sensitive approach for CDD, and monitoring is a crucial part of it.

CDD has always been a key element of a money laundering control program. CDD also makes good business sense as it allows firms to tailor their products and services to the needs of their customers, and in some cases to prevent fraud. The Third EU Directive repeats the main CDD requirements of the first and second Directives, but adds more detail to the requirements by, among others, including a specific requirement of ongoing monitoring, on a risk sensitive basis, of the business relationship.

So, monitoring for suspicious activity has officially become a required facet of customer due diligence under the Directive. And we need to do it using a risk-based approach. What does that mean?

The risk-based approach is principally about performing a thorough risk assessment and then allocating resources and attention to areas of higher money laundering (but not necessarily terrorist financing) risk, and reducing AML investment in areas of lower risk. This allows us to minimize the adverse impact of anti-money laundering procedures on their legitimate customers. Firms must however be able to demonstrate to the supervising authorities that the extent of the measures is appropriate to the risks of money laundering and terrorist financing, which is not always easy.

Monitoring of customers and transactions should be done in a manner consistent with a "reasoned" risk assessment. Automated transaction monitoring solutions can help in many ways to achieve this. Not all risks can be seen at the account opening moment. Risks for some customers may only become evident once the customer has begun transacting either through an account or otherwise in the relationship with the financial institution. That is why appropriate and reasonable back end monitoring of customer transactions is an essential component of a reasonably designed risk-based approach in CDD.

Here are some examples of back end monitoring of customer transactions: Financial institutions typically store a lot of customer and account characteristics, to be used in a risk-based approach for transaction monitoring. "Static" risk factors captured at the account opening process such as PEP status, High/Medium/Low risk classification, country of nationality, account type, missing identification info, etc. can all be used in combination with transaction characteristics to decide whether or not to generate an alert, and prioritize the alerts based on risk. Peer group analysis is another important component of CDD, as it enables the bank to determine what is normal behavior for certain types of customers and businesses. Supermarkets and convenience stores are

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both cash intensive businesses, but will show different behavior in terms of turn over in the accounts. Only when compared properly (supermarkets with supermarkets) you can detect what is abnormal.

These issues are all integral components of the risk-based monitoring requirement under the EU Directive.

The risk-based approach means that you can make certain decisions that can help save money. It helps firms target their resources away from products or customers that are known to be unattractive to money launderers. But don't get too enthusiastic now. Not everything is risk-based. Unlike the monitoring, generally, one would say that suspicious transaction *reporting* regimes are not risk based. When the threshold of suspicion is reached, reporting should occur, and there is no ability to apply a risk-based approach.

From 2001 – 2005, Saskia Rietbroek, CAMS, served as the original Executive Director of the Association of Certified Anti-Money Laundering Specialists (ACAMS). She serves on the Advisory Board of ACAMS. In 2005, she founded AML Services International LLC and conducts money laundering audits and training for financial institutions in the US, Caribbean, and Latin America. She is also Financial Crime Advisor to NetEconomy, a leading company in financial crime detection. She is based in Miami, FL.
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