

RISK-BASED INDUSTRY BASELINE

EDD measures for **EC high risk third countries**

CONTEXT

Introduction

Wwft article 9 requires banks to apply a list of Enhanced Due Diligence (EDD) measures to transactions, business relationships and correspondent relationships related to EC high risk third countries (HRTC) as set out in Article 9(2) of Directive (EU) 2015/849.

The EDD measures of Wwft article 9 should however be applied in an ML/TF risk relevant manner contributing to the purpose of this article. This means that where there are risks related to the countries designated by the EC, these risks should be managed and mitigated by applying risk-based controls.

The NVB Industry Baseline describes the risk-based Dutch banking practice to implement the above requirements for low, neutral and high risk scenarios. The indicated risk level of a scenario should be interpreted in the full context of the client, in this case with focus on the specific risks related to EC HRTC.

It is essential that the Wwft article 9 EDD measures are applied proportionate to the identified risks and taking into account the specific circumstances of the business relationship or transaction. Banks can adjust the extent and application of the measures in Wwft article 9 on a risk-sensitive basis. Meaning that banks will diligently assess the risks associated with the business relationship and transactions and take a risk-based decision on how to proportionately

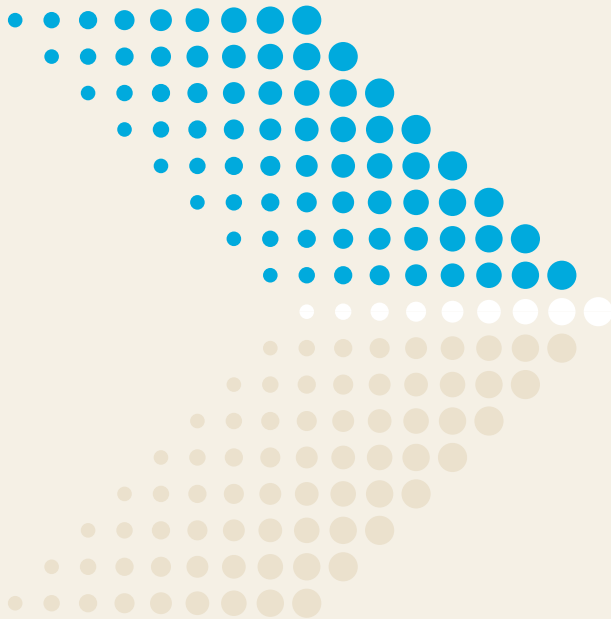
apply measures from Wwft article 9. Obtaining additional information is only needed if it can be used to mitigate perceived risks.

The NVB Industry Baseline describes how to perform the EDD measures stipulated in Wwft article 9 in a risk relevant manner. Additionally, some elements are highlighted where the revised 4AMLD and EBA Risk Factor Guidelines provide a more risk-based approach, which should be considered when implementing Wwft article 9.

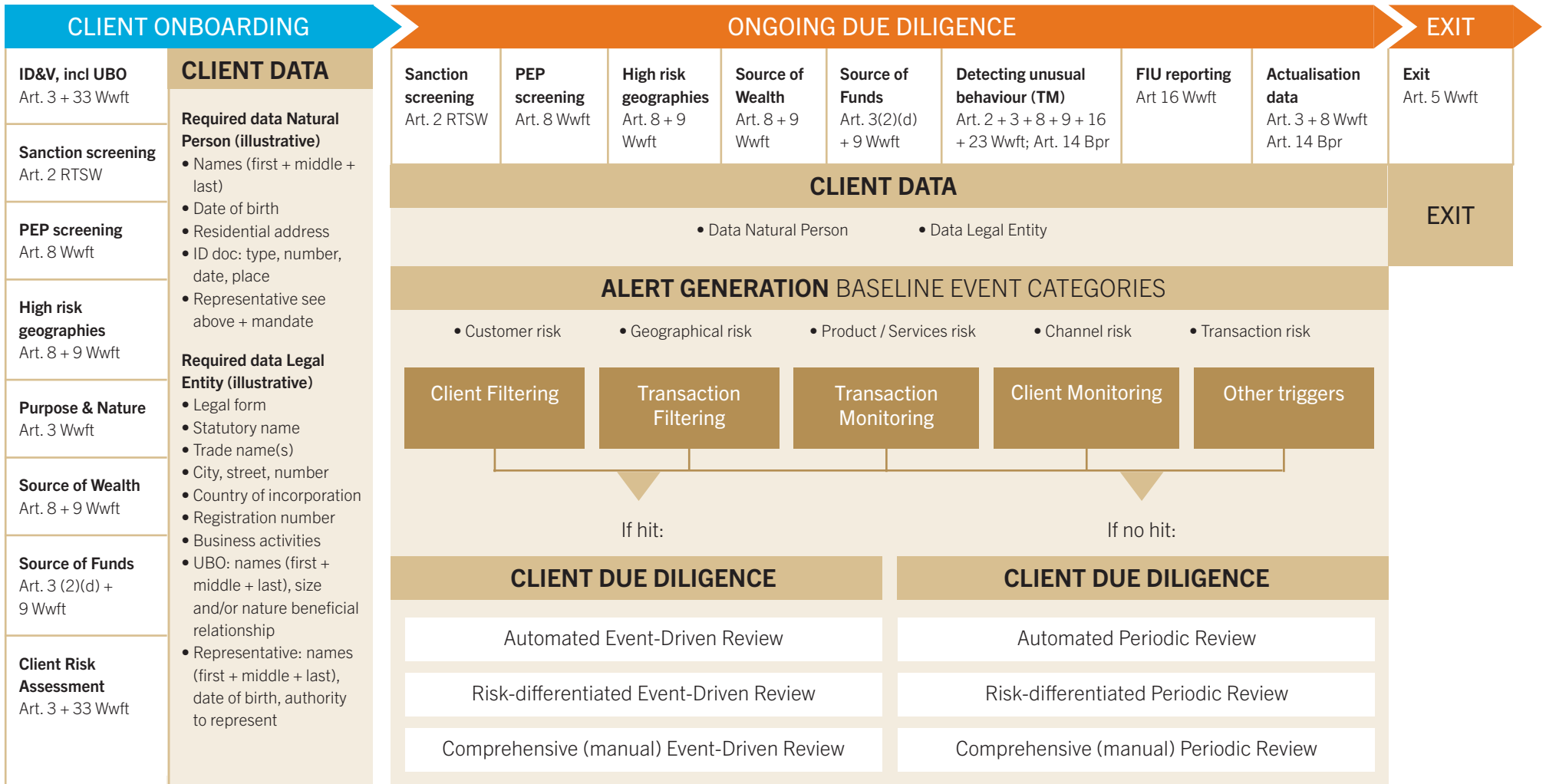
The Industry Baseline also explains the difference between the application of the EDD measures with respect to occasional transactions which is different from transactions that are performed within the context of the business relationship. It contains as well, EDD measures for a correspondent relationship with an institution in an EC HRTC and transactions to or from an EC HRTC executed via a correspondent relationship.

Positioning within the Financial Crime Framework

Risk-based EDD measures with respect to business relationships, correspondent relationships, or transactions involving high risk third countries identified pursuant to Article 9(2) of the revised 4AMLD are mitigating measures for ML/TF risks in both CDD and TM processes.



FINANCIAL CRIME FRAMEWORK



- Regulatory requirement
- CDD & TM processes at Bank
- Risk trigger mechanism /Models at Bank

1 Industry Baseline

For banks it is important that risks are assessed and controlled where necessary. This means that where a risk is detected the mitigating measures should focus on that specific risk bearing the purpose of the legislation in mind.

Wwft article 9 requires banks, in case a transaction, business relationship or correspondent relationship is related to an EC HRTC, to obtain additional information on among others the client, UBO and the intended nature of the business relationship. Information also needs to be obtained on the source of funds (SoF) and source of wealth (SoW) of the client and UBO, as well as the reason for the transaction.

EDD measures for transactions with an EC HRTC executed within a business relationship need to be applied when performing reviews (both event and time drive) and to the extent that the measures have not already been adequately applied. To continuously monitor transactions, banks use a number of (automated) risk triggers and scenarios to detect among others unusual transactions with an EC HRTC. A transaction with an EC HRTC is reason to generate an alert, but the processing and level of alert handling may vary. When transactions with an EC HRT are part of the client's risk profile or expected transaction behaviour, an alert can be automatically processed and closed. Thus, Wwft article 9 has been applied.

In low and neutral risk scenarios, banks already have collected the client information that will be adequate to assess relevant ML/TF risks and where necessary, to mitigate these identified risks. Banks will assess the available information, which can be done in an automated way, to establish adequate mitigation of ML/TF risks. In those cases banks only need to obtain (additional) information when the recorded information is not sufficient to mitigate the risks.

Banks will always record to what extent the already available information is sufficient. In these low and neutral risk scenarios, banks may consider the purpose of Wwft article 9 while also considering the risk relevance of the EDD measures. Where additional information is necessary, this can be collected via desk research without the obligation to reach out to the client. When from the performed desk research no higher risk indicators are identified and this is documented adequately, the ML/TF risks are deemed to be adequately mitigated.

For instance, for existing business relationships where, as part of the risk profile or the expected transaction behaviour, the bank has already considered the fact that the client receives funds from or sends funds to an EC HRTC or has professional links with an EC HRTC, EDD has been executed and as such EDD measures are not needed for every transaction with this EC HRTC. This risk has already been assessed and mitigated and is part of the risk profile. As long

as the CDD or EDD measures that have been taken are adequate and the transaction fits the expected transaction profile, no additional information needs to be obtained. Thus, for transactions performed within a business relationship, (further) EDD measures only need to be applied when performing reviews.

In case a client executes a transaction related to an EC HRTC, which is not part of the client's risk profile or expected transaction behaviour, banks first determine whether it constitutes a low, neutral or high risk scenario.

For instance, when a client pays for holiday expenses in an EC HRTC or a small one-off transaction to an EC HRTC, banks can deduct from the type of transactions and the context of the client that it represents a low or neutral risk scenario. By means of desk research (e.g. type of payment, client risk profile) banks can demonstrate that adequate information is already available and obtaining additional information will not contribute to risk relevant mitigation.

To assess whether the situation represents low or neutral risk, banks can also apply risk-based thresholds for amounts and frequency for transactions related to EC HRTC in a certain period.

When a transaction related to an EC HRTC is outside the client's risk profile and expected transaction behaviour, it could potentially indicate a higher risk

(e.g. because of the amount or frequency). As risk relevant measure banks can then obtain additional information regarding the context of the transaction via desk research or client outreach.

1.1 Senior management approval

One of the EDD measures according to Wwft article 9 is to obtain approval from senior management for entering into or continuing the business relationship when it relates to an EC HRTC. The purpose of this EDD measure is to demonstrate the accountability of senior management for accepting ML/TF risks. Moreover, by deciding on the risk appetite, approving the systematic integrity risk analysis (SIRA) and signing-off on the AML/CFT policy ensures their accountability with regard to managing risks of transactions and business relationships related to EC HRTC.

The Wwft defines senior management as the persons who determine the day-to-day policy of an institution, or the persons working under the responsibility of an institution, who perform a management function directly below the echelon of the day-to-day policy-makers and who are responsible for natural persons whose activities affect an institution's exposure to ML/TF risks.

This definition deviates from the definition of 'senior management' in the revised 4AMLD. In the 4AMLD senior management means an officer or employee with sufficient knowledge of the institution's ML/TF risk exposure and sufficient seniority to take decisions affecting its risk exposure, and need not, in all cases, be a member of the board of directors.

The 4AMLD leaves room for approval at a lower level in an institution. Senior management may therefore in a low and neutral risk scenario delegate their mandate to approve these business relationships to lower management, fitting (i) size of the obliged entity and (ii) risks identified with the business relationship. The establishing and operationalising delegation of this mandate will be executed according to the bank's governance model. A delegation framework encompasses, among others, the following elements:

- description of risk-based scenarios where approval is delegated by senior management and scenarios to be submitted to senior management for confirmation;
- knowledge and decision level of delegated officials;
- reporting obligation to senior management;
- audit trail of the implementation.

Delegated officials should:

- have sufficient knowledge of ML/TF risks;
- have the appropriate decision level, and
- be adequately informed regarding risks of transactions and business relationships related to EC HRTC.

To ensure accountability of senior management, a reporting obligation to senior management should be part of the delegation of the mandate. This reporting encompasses the exposure with respect to business relationships and transactions related to EC HRTC.

The reporting method includes:

- frequency and manner of reporting, including information on alerted, investigated and closed

transactions, either manually or in an automated way;

- scenarios submitted to senior management for confirmation;
- monitoring and auditing by 2nd and 3rd LoD of the delegation framework.

1.2 Obtaining 'additional' information

Several EDD measures in Wwft article 9 contain requirements to collect additional information. To purposeful adhere to Wwft article 9, the table below states the risk relevant mitigating measures per risk scenario.

In general, for low and neutral risk scenarios, information that is already available from the CDD processes will generally satisfy the requirement to collect 'additional' information. Banks will assess the available information to determine that it satisfies the purpose and intent of the individual EDD measures in a proportionate manner. In high risk scenarios, additional information should be obtained via desk research or client outreach.

Similarly, when a country becomes an EC HRTC, the bank will for all clients that are affected by that new listing of the country, first check that available information will satisfy the requirement to collect 'additional' information, and where necessary, obtain additional information via desk research or client outreach. No lookback is required on the transactions of the clients previous to the listing of that country.

EDD MEASURES WITH LOW, NEUTRAL AND HIGH RISK

a Collect additional information related to the client and UBO(s)

LOW AND NEUTRAL RISK Information gathered during CDD process of Wwft article 3 is adequate.

HIGH RISK Additional information can be requested from the client or collected via desk research (e.g. activities, employment).

b Collect additional information related to the purpose and nature of the business relationship

LOW AND NEUTRAL RISK When aligned with the established purpose and nature (also if by peer grouping), no additional information needed.

HIGH RISK Additional information can be requested from the client, (e.g. further transactions, annual accounts) or collected via desk research.

c1 Collect information regarding the source of funds, which are used in the business relationship or transaction.

LOW AND NEUTRAL RISK Assessment of information collected on SoF as part of the regular CDD process is adequate.

HIGH RISK Additional SoF information can be requested from the client or from a reliable source (e.g. income statements, tax declaration).

c2 Collect information regarding the source of wealth of the client and of the UBO(s).

LOW AND NEUTRAL RISK Information can be collected via desk research, with a plausibility check but no obligation to reach out to client and/or UBO.

HIGH RISK Collect information via desk research or information request to the client and/or UBO (e.g. tax declaration).

d Collection of information regarding the background and reasons of the proposed or performed transactions.

LOW AND NEUTRAL RISK When in line with the risk profile or expected transactions,, no additional information needs to be collected. When outside risk profile or expected transactions, additional information should be obtained on context of the transaction via desk research or client outreach.

HIGH RISK Client outreach to collect information on the specific transactions, e.g. invoices, booking confirmations, to the extent not already available.

e Obtaining senior management approval regarding establishing or continuation of the business relationship.

LOW AND NEUTRAL RISK When in line with the risk profile or expected transactions, senior management approval is already assigned at client acceptance. When outside risk profile or expected transactions, the mandate for approval may delegated in accordance with the delegation framework.

HIGH RISK Senior management approval in accordance with the delegation framework. Senior management must be sufficiently informed on transactions and business relationships related to EC HRTC.

f Conducting enhanced monitoring of the business relationship and transactions of the client by increasing the number of controls applied and increasing the frequency of actualization of the information of the client and the UBO(s) and selecting patterns of transactions that need further examination.

LOW AND NEUTRAL RISK Having adequate transaction monitoring controls in place (including for EC HRTC) meets the requirement of enhanced monitoring. EDD measures for transactions with an EC HRTC executed within a business relationship only need to be applied when performing reviews.

HIGH RISK High risk clients are typically subject to more frequent reviews. Having adequate transaction monitoring controls in place (including for EC HRTC) meets the requirement of enhanced monitoring.

2 Impact

In low and neutral risk scenarios the full EDD measures of Wwft article 9 are regarded by banks as not purposeful nor risk relevant. Outreach to clients in these scenarios is considered disproportionate and is experienced as unnecessary and burdensome for both client and bank. Relying in low and neutral risk scenarios on available CDD information and desk research is in accordance with the risk profile of these clients and transactions. However if information is not available or the transaction cannot be explained, client outreach is needed. The administrative burden for clients and banks is thus reduced and less intrusive when no client outreach is needed. This risk-based approach of the Wwft article 9 EDD measures is aligned with EBA Risk Factor Guidelines and explainable to society.

3 Use cases

Please note that the use cases below are examples to illustrate a practical application of this Industry Baseline and not intended to be exhaustive.

LOW RISK

Example

Client with private current account is in an EC HRTC for a vacation. Client withdraws cash and makes frequent payments at restaurants, shops and a hotel for a period of three weeks; transactions range from e.g. €5-1,000 per transaction.

Industry Baseline

- Assess if available information on the client and transactions adequately meets the 'additional' information requirements.
- When transactions are in line with expected tourist expenses, no additional EDD measures need to be performed, including no senior management sign-off and no additional controls – in accordance with the delegation framework.
- Recording that the available information satisfies the EDD measures.

LOW RISK

Example

Client periodically remits funds to an EC HRTC to support family; transactions range from e.g. €50-500 per transaction.

Industry Baseline

- Family support transactions have been assessed in CDD process, EDD measures are applied in a risk relevant manner, and are part of risk profile or expected transaction behaviour.

- If transactions are in line with risk profile or expected transaction behaviour, no additional EDD measures need to be performed, including no SoF, SoW and no senior management sign-off – in accordance with the delegation framework.
- No additional controls, other than regular transaction monitoring.

NEUTRAL RISK

Example

Dutch company imports agricultural products (flowers) from an EC HRTC, UBOs are resident in the Netherlands. Invoices have been received.

Industry Baseline

- Transactions have been assessed in CDD process, EDD measures are applied in a risk relevant manner, and are part of ETP.
- If transactions are in line with risk profile and ETP, no additional EDD measures need to be performed, including no SoF, SoW and no senior management sign-off – in accordance with the delegation framework.
- No additional controls, other than regular transaction monitoring.

NEUTRAL RISK

Example

Wholesale client with a 100% ultimate parent listed on a recognized exchange in a low risk country, with branches in an EC HRTC and UBOs residing in EU.

Industry Baseline

- Activities have been assessed in CDD process, EDD measures are applied in a risk relevant manner.
- Risk profile, including expected transaction behaviour, is established by taking into account the frequency and volume of transactions to/from the branches and updated when circumstances change.
- If activities and transactions are in line with risk profile or expected transaction behaviour, no additional EDD measures need to be performed, including no Sof, SoW or senior management sign-off – in accordance with the delegation framework..
- No additional controls, other than regular transaction monitoring.

NEUTRAL RISK

Example

Respondent relationship whereby a Dutch bank is only intermediary for transactions to or from an EC HRTC (both originator and beneficiary are not the Dutch bank's clients).

Industry Baseline

- Respondent relationship has been assessed in accordance with correspondent banking EDD measures at onboarding and during reviews.
- Transactions to and from EC HRTC have been assessed, EDD measures are applied in a risk relevant manner and are part of the expected transaction behaviour of the respondents.
- No additional controls, other than regular transaction monitoring involving EC HRTC.
- Reliance on the respondents.

HIGH RISK

Example

A Dutch 'Fonds voor Gemene Rekening' managed by a Dutch fund manager (AFM licensed) with adverse media, with several participants spread over multiple jurisdictions (including EC HRTC), complex structure with an intermediate layer in EC HRTC, investing in multiple companies active in various sectors. Transactions to and from the companies invested in are in line with expected transaction behaviour.

Industry Baseline

- Activities have been assessed during CDD process and EDD was applied at onboarding and during reviews.
- Additional information from (i) fund manager due to adverse media and on SoF and SoW; (ii) participants from high risk jurisdictions, including SoF and SoW.

- Additional information on (i) background and reasons for the complex structure and (ii) regarding tax impact.
- Additional information on investee companies.
- Senior management confirmation – in accordance with the delegation framework.
- Enhanced controls in place and frequent reviews due to high risk classification.

HIGH RISK

Example

Correspondent relationship of a Dutch bank with a respondent from an EC HRTC.

Industry Baseline

- Respondent relationship has been assessed in accordance with correspondent banking and Wwft article 9 EDD measures at onboarding and during reviews.
- Senior management confirmation – in accordance with the delegation framework.
- Enhanced transaction monitoring involving EC HRTC, which are assessed based on risk profile or the expected transaction behaviour.
- Frequent reviews due to high risk classification.

Regulatory framework

The regulatory context for this topic is described in relevant parts of applicable laws, regulations and guidelines from various authorities, such as: FATF, EBA, Ministry of Finance and DNB. Below an overview of the current regulatory framework with reference to EDD measures for EC high risk third countries.

- **FATF Recommendation 19**

“Financial institutions should be required to apply enhanced due diligence measures to business relationships and transactions with natural and legal persons, and financial institutions, from countries for which this is called for by the FATF. The type of enhanced due diligence measures applied should be effective and proportionate to the risks.”

- **FATF Interpretive Note to Recommendation 19**

“The enhanced due diligence measures that could be undertaken by financial institutions include those measures set out in paragraph 20 of the Interpretive Note to Recommendation 10, and any other measures that have a similar effect in mitigating risks.

Paragraph 20: Examples of enhanced CDD measures that could be applied for higher-risk business relationships include:

- obtaining additional information on the customer (e.g. occupation, volume of assets, information available through public databases, internet, etc.), and updating more regularly the identification data of customer and beneficial owner;
- obtaining additional information on the intended nature of the business relationship;
- obtaining information on the source of funds or source of wealth of the customer;
- obtaining information on the reasons for intended or performed transactions;
- obtaining the approval of senior management to commence or continue the business relationship;
- conducting enhanced monitoring of the business relationship, by increasing the number and timing of controls applied, and selecting patterns of transactions that need further examination;
- requiring the first payment to be carried out through an account in the customer’s name with a bank subject to similar CDD standards.”

- **Article 18a Revised 4AMLD**

“With respect to business relationships, transactions involving high-risk third countries identified pursuant to Article 9(2), Member States shall require obliged entities to apply the following enhanced customer due diligence measures:

- a obtaining additional information on the customer and on the beneficial owner(s);
- b obtaining additional information on the intended nature of the business relationship;

- c obtaining information on the source of funds and source of wealth of the customer and of the beneficial owner(s);
- d obtaining information on the reasons for the intended or performed transactions;
- e obtaining the approval of senior management for establishing or continuing the business relationship;
- f conducting enhanced monitoring of the business relationship by increasing the number and timing of controls applied, and selecting patterns of transactions that need further examination.

Member States may require obliged entities to ensure, where applicable, that the first payment be carried out through an account in the customer’s name with a credit institution subject to customer due diligence standards that are not less robust than those laid down in this Directive.”

- **EBA Risk Factor Guidelines, paragraphs 4.53-4.57**

“4.53. With respect to a business relationship or transaction involving high-risk third countries as set out in Article 9(2) of Directive (EU) 2015/849, firms should ensure that they apply, as a minimum, the EDD measures set out in Article 18a(1) and, where applicable, the measures set out in Article 18 a(2) of Directive (EU) 2015/849.

4.54. Firms should apply the measures listed in guideline 4.53 and should adjust the extent of these measures on a risk-sensitive basis.”

- **Wwft article 9**

“Without prejudice to Article 8(1), in respect of transactions, business relationships and correspondent banking relationships related to states designated as higher risk of ML or TF by delegated acts of the EC pursuant to Article 9 of the 4AMLD, an institution shall carry out the following enhanced investigative measures:

- collecting additional information on those clients and beneficial owners;
- collecting additional information regarding the purpose and nature of that business relationship;
- collecting information on the origin of the funds used in that business relationship or transaction and the source of those clients’ and those beneficial owners’ assets;
- gathering information on the background to and rationale for the proposed or executed transactions of those clients;
- obtaining senior management approval for entering into or continuing that business relationship;
- conduct heightened monitoring of that business relationship with and the transactions of those clients, by increasing the number of checks and frequency of updates of data on those clients and those ultimate stakeholders and by selecting transaction patterns that require further investigation.”

- **Wwft Explanatory Note to article 9**

“Various responses draw attention to the additional burden that these stricter measures entail on the institutions. However, the directive requires these stricter measures. The directive does not allow for derogations from this. The Directive requires an

institution to comply at least with the obligations laid down in Article 9(1). The application of these obligations can be risk-based. The depth of CDD and the intensity with which the enhanced measures should be applied depend on the identified risk. In this case, too, an institution is expected to be able to explain why this degree of intensity has been applied in a particular case.”

Relationship between ‘DNB Good Practices’ and ‘NVB Industry Baseline’

DNB aims to illustrate its supervisory practices to the benefit of supervised entities by, for example, providing an interpretation of regulatory requirements (Q&As) and examples on how regulatory requirements can be met (Good Practices). It is important to note that neither the DNB Q&As nor Good Practices are legally binding.

The NVB Industry Baseline describes the application and execution of the risk-based approach in more detail, especially in cases where a transaction with an EC HRTC takes place within the context of a business relationship. Additionally it provides more practical examples on mitigating measures that can be applied in low, neutral and high risk scenarios.



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