Approved by the Decision No1/1154A
Dated November 11, 2008
Of the Chairman of the Central Bank of the Republic of Armenia

Guidance for
Financial Institutions on Adopting the Risk-Based Approach for Combating Money Laundering and Terroristm Financing

CONTENT

Introduction

This Guidance is presented based on Part 2, Article 11 of the RA Law on Anti-Money Laundering and Combating the Financing of Terrorism (hereinafter the Law) and is applicable to financial institution reporting entities as prescribed by Article 3 of the Law. The Guidance specifies the risk categories, their definitions and factors impacting the definitions, as well as the principles for risk level analysis and oversight.

The classified approach for risk management supports the implementation of the appropriate strategy for potential risk management providing for financial institutions to conduct oversight over the customer in a classified manner and in accordance with the risk profile of the customer by means of effectively exploiting human and technical resources of the institution. From this point of view it becomes important to classify customers depending on riskiness, accordingly to higher, medium and lower risk levels, where potential ML/TF risks in financial institutions can be effectively controlled by means of implementing a classified approach for each level or risk.

The concepts used in this guidance shall be applied according to the definitions prescribed by the Law.

Part 1. Criteria for Risks Relevant in the Field of Combating ML and FT by Financial Institutions

Chapter 1. Country/ Geographic Risk

1. Factors that may result in a determination that a country poses higher risk include:
1) a country is involved in the transaction, which is subject to embargoes, sanctions or other similar measures issued by the UN,
2) a country is involved in the transaction, which is identified as lacking appropriate arrangement and implementation of AML/CFT laws, recommendations and regulations according to the information published by credible sources (e.g. FATF, IMF, World Bank and Egmont Group),
3) a country is involved in the transaction, which is identified as having significant level of corruption and criminal activity according to the information published by credible sources (e.g. Transparency International, GRECO, Doing business, BEEPS, etc.),
4) a country is involved in the transaction, which is identified as supporting the financing of terrorism, or having more frequent terrorist acts performed within them according to the information published by credible sources (e.g. national security services of different countries, publications in media).

2. Except for the aforementioned factors, based on its own experience and operational distinctions, every financial institution is entitled to determine whether a country or a territory poses higher risk, in case it is not enlisted within the mentioned criteria.

Chapter 2. Customer Risk

3. Categories of customers, whose activities may pose a higher risk include:
1) politically exposed persons (information on PEP-s can be obtained from various publicly available resources, i.e. the official web site of the Central Intelligence Agency of the USA, the web sites of relevant state authorities of different countries, etc). Besides that, various paid databases exist as well (e.g. World-check, Factiva), which provide quite comprehensive information on politically exposed persons),
2) customers, where frequent and unexplained movements of funds to various financial institutions are exercised with the accounts thereof,
3) customers, where the structure or nature of their transactions and/or business relationships complicate the disclose of actual beneficial owner,
4) customers conducting cash intensive businesses, including money service businesses (e.g. remittance houses, currency exchange houses), casinos, betting and gambling service providers or customers that while not normally cash intensive, generate substantial amounts of cash for certain transactions,
5) non-profit organizations,
6) accountants, lawyers or professional persons carrying out similar activities, who are serviced in financial institutions and act on behalf of their customers,
7) intermediaries (financial or non-financial), whose activities are not subject to regulation by AML/CFT legislation,
8) non-resident customers,
9) customers using bearer negotiable securities, i.e. bearer negotiable cheque books.

Chapter 3. Product/Service Risk

4. Certain services provided by financial institutions can be determined to pose higher risk of money laundering. Those include:

1) provision of private banking services to a limited number of special customer categories (private banking),
2) banking transactions over the web (remote control of accounts, on-line banking),
3) international corresponding bank accounts relationships,
4) customer crediting where the credits are collateralized by a deposit allocated in the same institution,
5) transactions between a legal person and a natural person interrelated to another legal person,
6) transactions, where organizations registered in off-shore countries/territories are involved,
7) internet supply.

5. Worth to mention that a lower risk product can be identified as posing higher risk, if the customer acquiring the product has been assigned to higher risk category by the financial institution (e.g. insurance payments made by a politically exposed person).

Chapter 4. Variables That May Impact the Perceived Risk Level

6. Risk-based approach methodology may take into account risk variables specific to a particular customer or a transaction and can impact the relevant perceived risk level. That is, these variables may increase or decrease the risk assigned to a particular customer or a transaction. Those include:

1) the perceived “normal” or “abnormal” behavior of the customer specified by the identity of the customer,
2) the purpose of the bank account or the category of the business relationship,
3) the volume of funds to be placed on the account by a particular customer or the amount of the transaction undertaken,
4) the system of regulation, control and oversight to which a financial institution customer is subject,
5) the duration of the business relationship and the regularity,
6) the familiarity with the country, including knowledge of local laws, regulations and rules,
7) the use of intermediary corporate vehicles or other structures that have no apparent commercial or other rationale or that unnecessarily increase the complexity of the transaction/business relationship and result in a lack of transparency, etc.

Part 2. Customer Due Diligence, Risk Analysis and Oversight

Chapter 1. Customer Due Diligence

7. The implementation of Know Your Customer principle enables the financial institution to form a reasonable belief that it possesses necessary information on the identity of each customer as well as is aware of the types of transactions that the customer is conducting or is likely to undertake. Financial institutions are required to implement the following procedures:

1) identify and verify the identity of each customer on a timely basis,
2) take reasonable measures to identify and verify the identity of any actual beneficial owner,
3) identify the authorized person of the customer in cases where applicable, and verify the identity and the power of authorization,
4) obtain sufficient information to understand the customers’ circumstances and business activities, including the expected nature and level of transactions.

8. The starting point for a financial institution is to assess the risks of the customer taking into consideration any appropriate risk variables before making a final determination. The approaches for customer due diligence conducted by financial institutions relevant to each customer, may be the following:

1) a normal level of due diligence to be applied to all customers,
2) the normal level being reduced in recognized lower risk categories, such as:

- natural persons whose main source of funds is derived from salary, pension, social benefits from identified sources, where the features of the certain transaction are not materially different from regularly exercised transactions,
- customers, where the information on their identity and actual beneficial owners are publicly available and whose activities are subject to oversight by state authorities,
- certain transactions, where de minimis amounts for are required for execution (e.g. utility payments, insurance payments, etc.).

3) inhanced level of due diligence in respect of higher risk customers,

9. Financial institutions are required to undertake appropriate measures and conduct oversight for mitigating the ML/TF risks of customers, who have been identified by relevant financial institutions to pose higher risk as a result of the implemented risk-based approach. These measures and oversight may include:

1) ensuring high level of awareness on higher risk customers and transactions of the financial institution,
2) applying increased level of Know Your Customer principle or enhanced due diligence,
3) enhanced monitoring of transactions,
4) increased level of on-going oversight and regular review of business relationships/continuous monitoring.

Chapter 2. Risk Level Analysis and Oversight

10. In order for financial institutions to have effective risk-based approaches, special methodologies must be developed and implemented, which assumes that systems for certain analyses and oversight must be in place for managing the particular types of risk categories. Such methodology can be the combination of the following series of steps:

1) to monitor the product/service, the serving method, the category of customer, the location,
2) to monitor whether the risk variables pose the particular transaction/business relationship to a higher risk level,
3) to determine the risk related to the transaction/business relationship as lower level, medium or higher and accordingly to initiate the following activities.

a) the minimum legal requirement for only the identification and address verification can be conducted in case of lower risk,
b) alongside identification and address verification, in case of medium risk the verification of the origin of funds is compulsory (personal account, etc.),
c) besides the aforementioned requirement, in case of higher risk, financial institutions are also required to verify the category of activity that the funds were derived from.

11. The due diligence conducted by the financial institutions must also be performed with a similar logic, that is, simplified due diligence is conducted for lower risk levels, normal due diligence is conducted in case of medium risk, while the higher risk requires regular and enhanced measures of due diligence. Such an approach may be applied in other procedures as well. For example, if the customer or the potential customer are identified to pose lower risk, then the establishment of a business relationship with him/her does not require senior management's permission, which is compulsory, for example, in case of politically exposed persons.