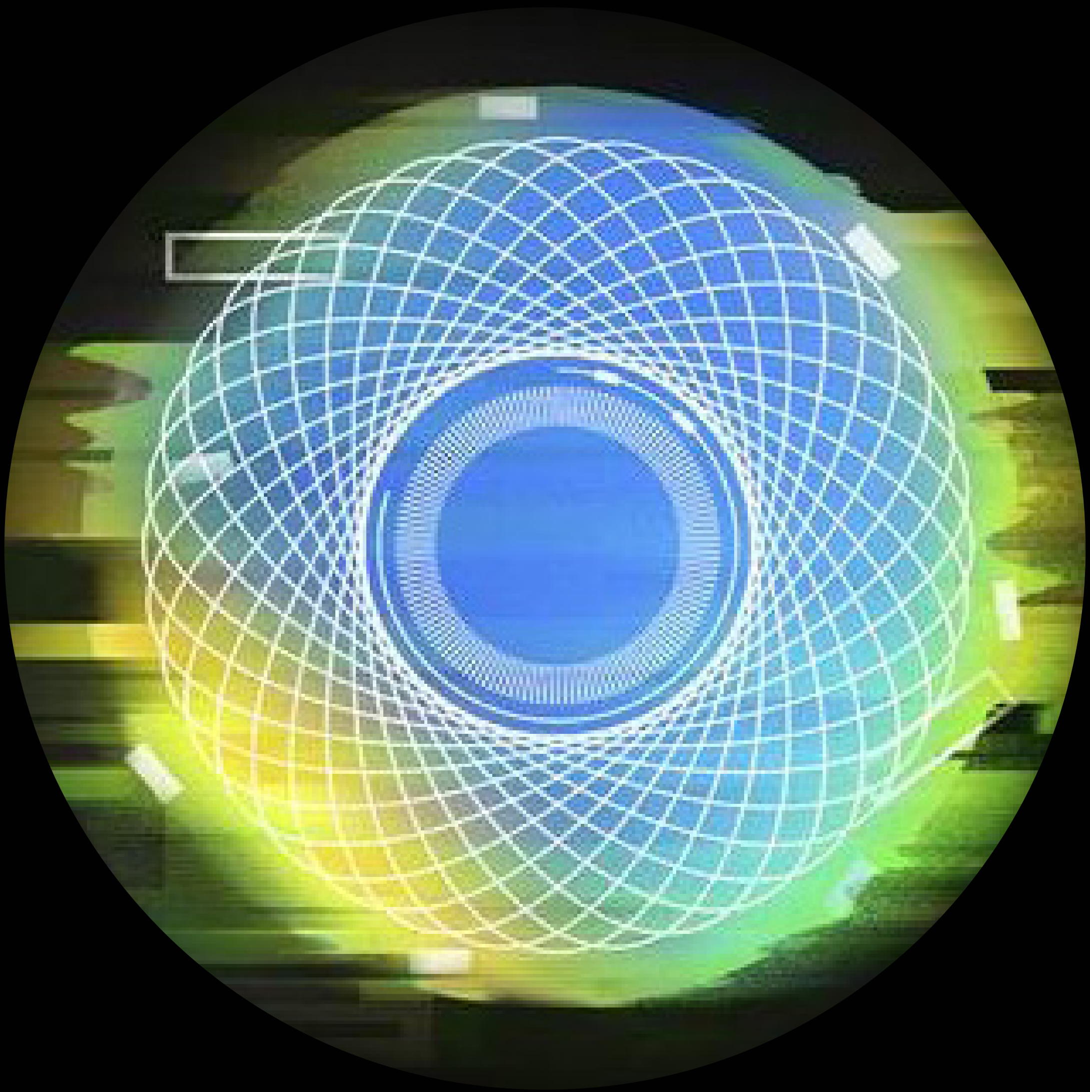


The Future of Financial Crime: Delivering a risk-based approach

The risk assessment has become a critical tool which sits at the heart of a Financial services (FS) institution's financial crime control framework. However, it is often a regulatory driven exercise, with generic evaluations of the Financial crime (FC) vulnerabilities that an institution is exposed to. Such outcomes provide limited actionable intelligence to enable appropriate adjustments to be made to financial crime controls. With financial crime threats ever-changing and becoming increasingly complex, this approach must evolve.

Typically, risk assessments (RAs) are often limited by the following:

Outdated intelligence about threats that is insufficient in the detail, accuracy and relevance needed to provide appropriate support for risk management. This results in a lack of specificity in the identification, assessment, and prioritisation of the precise FC risks that the organisation faces. This can also mean an inability to articulate the threats in terms of customers, geographies, and products;

A lack of clear and timely linkage from the risks and threats identified to the preventative and detective controls for mitigating the risks;

Static documents that are updated on an annual or bi-annual basis, with a significant time lag between changes in the RA and associated adjustments to the control framework in response. For example, it can take a number of months for transaction monitoring (TM) rules, or several years for changes in due diligence (DD) requirements and processes to react to a changing threat landscape; and,

Manual processes which do not provide a continuous view, meaning that risks are not quantified on a consistent basis or measured dynamically against relative likelihood and impact.

Unsurprisingly, expectations about the role of the RA are changing, driven by a number of factors. In recent years, regulatory visits and reviews have increased the focus on testing how well the RA recognises the specific threats the FS institution faces and how effectively it evaluates the underlying mitigating controls. Both are instrumental to delivering a risk-based approach. Regulatory enforcement can result where this is unsatisfactory. In the UK, the government's Economic Crime Plan 2 (2023 – 2026) has set out clear actions to drive a more dynamic response by FS institutions to the FC risks faced by the UK, this will require the development of a control framework that provides a mechanism for adjusting areas of focus, and 'dial-up' and 'dial-down' activities as risks evolve.

Adopting a more dynamic and integrated approach to RA and control modulation is key to addressing the limitations of RAs and meeting the changing regulatory expectations. Change can be incremental, and specific solutions will vary across FS institutions (based on sector, maturity, products and customer base), but it is our belief that the following changes are needed:

- **A move to a proactive RA process which combines intelligence from internal sources** (such as from previous cases, changes to the business, etc.) with the enhanced use of open-source intelligence, and increased and active engagement in public to private, intelligence sharing functions, to continuously update the understanding of the risks and articulate the specific threats faced by the organisation. The role of the financial intelligence unit (FIU) is critical here.

- **The implementation of a methodology to address the changing risks/threats,** by assessing and quantifying the inherent risk, and by assessing the current controls and their effectiveness, in order to calculate and document the residual risk - using quantitative measures (where available/applicable). Through this methodology, the level of risk mitigation and risk acceptance of residual risk should be aligned to the commercial ambitions and risk appetite of the FS institution and governed accordingly.

- **Greater integration of the RA, where possible, through dynamic values directly linked to the control framework.** For example, a dynamic link to the client DD scoring or scoring used in integrated monitoring and segmentation, to accelerate re-assessment when risks change. This would help to reduce the often significant costs associated with managing and responding to changes in risk.

- **For larger FS institutions, the RA and control library should be implemented in a suitable platform,** that can directly integrate with the control environment and provide demonstrable visibility of risks and controls.

In adopting these changes, we believe that it is possible to achieve **three key benefits:**

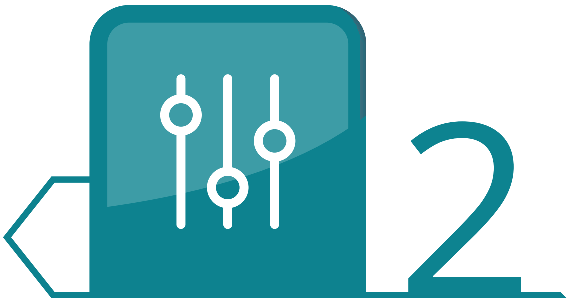
A demonstrable risk-based approach

Through the up-to-date identification and assessment of FC risks faced and the mitigating controls implemented by the FS institution, it will be possible to demonstrate to a regulator (or other stakeholders) that a risk-based approach has been implemented effectively.

A rigorous approach that is specific and has used appropriate sources and considered likely risks will provide a defensible position, in the event of regulatory scrutiny of a particular relationship or incident, and so reduce the likelihood of regulatory supervision or enforcement.

Better control design and management

By explicitly linking controls to the risks and providing a greater level of specificity in the risks and threats faced, the mitigating controls can be designed better to focus on preventing and detecting risk crystallisation. This documented linkage also reduces the possibility that key controls might be removed or updated inadvertently, without appropriate governance. Additionally, by providing clear identification of the underlying risks that are being mitigated, reviews, escalations and responses by an investigator can be more tailored, so that they are more effective and efficient.



Competitive advantage

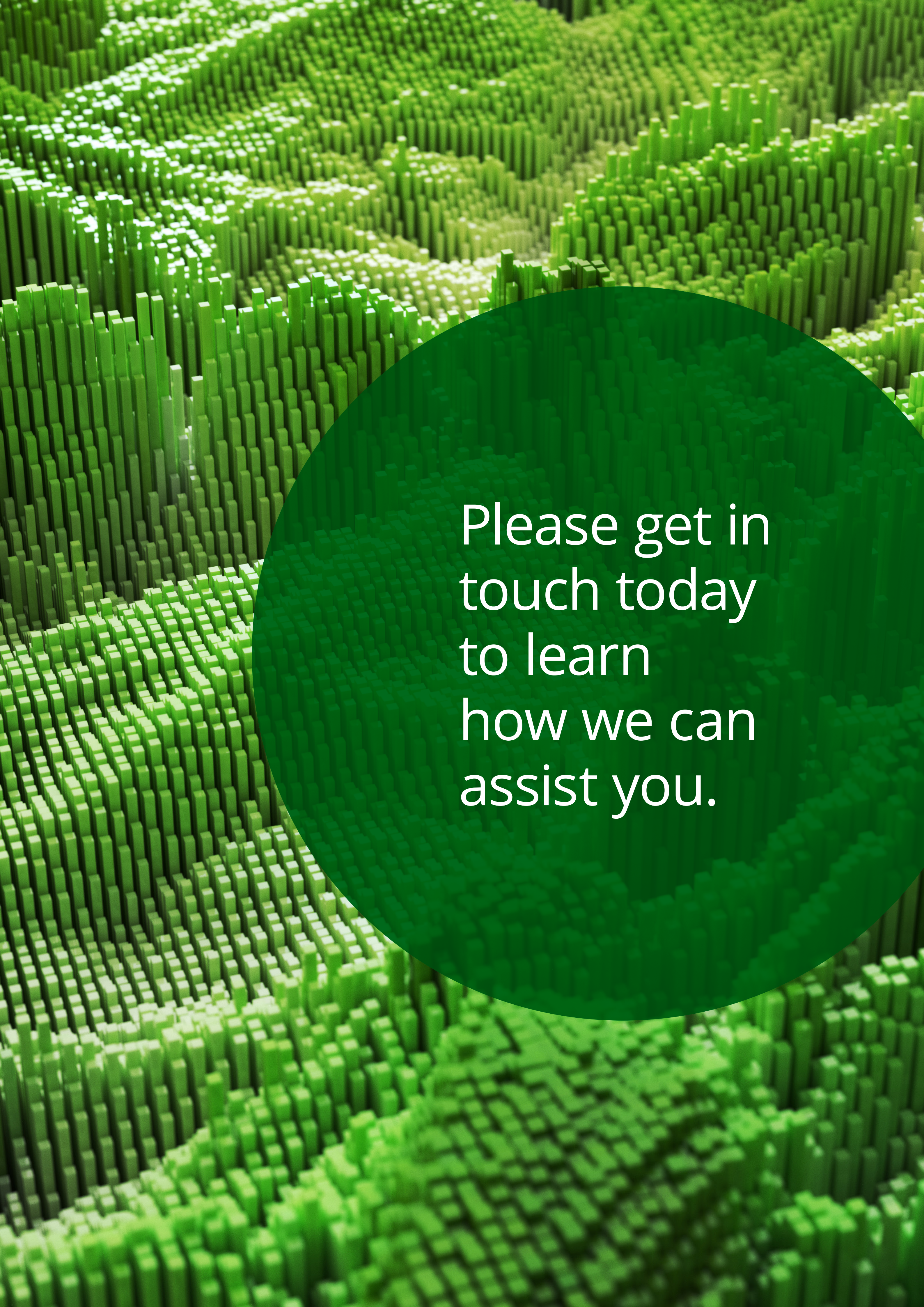
Organisations stand to gain a competitive advantage if they can rapidly focus their FC investments to mitigate the most serious risks. By focusing controls on the prioritised areas, there is an opportunity to be more efficient, by dialling down other controls as appropriate and achieving cost savings.

This more measured RA/control approach enables an FS institution to deal with emergent risks as 'business as usual' (BAU) and avoids the need for "fire drills" that disrupt normal operations.

Additionally, greater confidence in the effectiveness of the institution's controls will help an FS institution to grow through the safe offering of new products and services, and more effective pricing of this risk. This could also allow the entry into new jurisdictions, which could otherwise be outside of the organisation's risk appetite. We will explore this further in the upcoming article on dynamic customer lifecycle management.

In summary, the changes suggested here will deliver a sophisticated and proactive intelligence-led approach to managing risk that identifies the changing nature of FC threats and dynamically adjusts the mitigating controls on the highest priority risks, allowing the dialling down of effort in other areas.

We believe the evolution of the RA and control framework as set out in this article is fundamental to enabling further changes that are needed in a future financial crime capability. Specifically, changing the approach to due diligence to create a more dynamic customer lifecycle management, and the convergence of monitoring to allow the simplification and streamlining of FC operations. Overall, this will drive a move to a more effective and efficient approach to fighting financial crime.



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