

# Prevention of money laundering and terrorist financing: summary of sector-specific risk assessment – investment firms, management companies and AIFMs

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## 1 Purpose and scope of application of the sector-specific risk assessment

The sector-specific risk assessment is the Financial Supervisory Authority's (FIN-FSA) assessment of money laundering and terrorist financing (ML/TF) risks faced by investment firms, management companies and alternative investment fund managers (hereinafter "firms") at the sector level. In the FIN-FSA's [inherent risk assessment of money laundering and terrorism financing](#), risks related to different sectors were examined at the top level and only from the standpoint of products and services typically provided in the sectors. In the sector-specific risk assessment, the FIN-FSA studied in more depth the products and services offered by firms operating in the capital markets in as well as their clients, distribution channels and geographical coverage. In addition, risk management methods have also been considered. The assessment was formed at the sector level; not at the level of individual supervised entities.

The risk assessment guides the FIN-FSA in directing supervisory resources and selecting supervisory measures based on risk. In accordance with the guidelines on risk-based supervision issued by the European Banking Authority (EBA), the FIN-FSA must prepare a supervision strategy for preventing money laundering and terrorist financing, a key element of which is risk assessments specific to the various

supervised sectors. The supervision strategy takes a position on how to react to the identified risks and on the supervisory measures directed at different supervised entities.

Moreover, the supervision strategy serves as the basis for more detailed supervision plans. The risks identified in the risk assessment and the weaknesses identified in the risk management methods guide the supervisory measures directed at the sector by the FIN-FSA. The sector-specific risk assessment gives a top-level assessment of the risks related to the management methods. Verifying the effectiveness of management methods and compliance with the obligations of the Act on Preventing Money Laundering and Terrorist Financing (444/2017, the AML Act) therefore always requires more detailed supervisory measures.

The risk assessment concerns the following obliged entities under the AML Act:<sup>1</sup>

- Investment firms referred to in the Act on Investment Firms (747/2012), branches of EEA investment firms and third-country branches (53 investment firms).
- Fund management companies referred to in the Mutual Funds Act (213/2019) (25 management companies).
- Alternative investment fund managers (AIFM) with an authorisation of an AIFM referred to in the Act on Alternative Investment Fund Managers (162/2014) as well as AIFMs under the registration obligation referred to in said Act (total of 129 firms, also including management companies authorised as an AIFM).

Account operators under the notification obligation as referred to in the AML Act, investment funds' depositories and the central securities depository are not subject to the sector-specific risk assessment, since at the time of preparation of the risk assessment, they were not yet under any reporting obligation to the FIN-FSA's RA data collection<sup>2</sup>. Deposit banks and credit societies may provide investment services in addition to the activities under their authorisation (Act on Credit Institutions 610/2014, chapter 5, section 1(3)). Investment services provided by these obliged entities are not discussed in this sector-specific risk assessment.

In the risk assessment, obliged entities are divided into investment firms, management companies as well as authorised AIFMs and registered AIFMs.

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<sup>1</sup> Number of firms as at 31 December 2021

<sup>2</sup> Reporting of risks and controls concerning money laundering and terrorist financing.

## 2 Preparation of the risk assessment

When assessing the risks of money laundering and terrorist financing, the FIN-FSA uses the scale presented below, which is consistent with the scale used by the EBA. A risk score is defined to describe each risk level.

Risk level	Risk score corresponding to the risk level
Very Significant	4
Significant	3
Moderately Significant	2
Less Significant	1

The end result of the sector-specific risk assessment is the overall risk level determined for the entire sector and separately for investment firms, management companies as well as authorised AIFMs and registered AIFMs.

Overall risk is determined on the basis of the risk levels determined for the different risk and management method categories. Section 3.1 "Results of sector-specific risk assessment" reviews in more detail the principles followed in determining the overall risk.

The risk assessment draws upon the following FIN-FSA and Bank of Finland data collections as well as FIN-FSA's annual surveys and registers as data sources:

- FIN-FSA's RA data collection
- FIN-FSA's AIFMD data collection
- Bank of Finland's SIRA data collection
- FIN-FSA's annual capital markets survey
- FIN-FSA's registers

The sources of the assessment of risk factors and management methods include the EBA and FATF's publications and the national risk assessment of money laundering and terrorist financing:

- [EBA Risk Factors Guidelines](#)
- [FATF RBA-Securities-Sector](#)
- [National money laundering and terrorist financing risk assessment 2021](#)

Furthermore, the FIN-FSAs' inherent risk assessment of money laundering and terrorism financing and the obliged entities' own risk assessments were considered in preparing the assessment. Relevant information was also obtained from supervisors responsible for the firms concerned, and from the authorisation and registration process.

The assessment of the risk levels of the risk and management method categories was conducted as follows:

### 1) Risk category – products and services

In the FIN-FSA's inherent risk assessment of money laundering and terrorist financing, the inherent risk of money laundering involved in investment services (incl. investment funds) was regarded as **Moderately Significant** and the inherent risk of terrorist financing as **Less Significant**.

The sector-specific risk assessment examined which products and services are provided by investment firms, management companies and AIFMs, and what kind of risk is associated with the products and services.

The products provided in the sector are financial instruments defined in chapter 1, section 14 of the Investment Services Act.

The following considerations were examined and assessed with respect to each financial instrument:

- How liquid is the financial instrument?
  - What is the investment cycle like?
  - What are the redemption characteristics like?
- Are high-value transactions allowed?
- Is the transfer of ownership and/or pledging possible?
- Is it possible to trade the financial instrument in secondary markets?
- Is the financial instrument complex?
- Does the financial instrument have investor protection?

The services provided in the sector are defined in the Investment Services Act, Mutual Funds Act and the AIFM Act.

The services were assessed by the following criteria, among others:

- What kind of financial instruments are involved with the service?
- Is the service part of a chain of transaction orders involving several entities?
  - What is the role of the other entities like?
- Is it possible to transfer funds within the service with third parties?
  - Is it possible to verify within the service that the payer of a subscription is the holder of the investment product?
- Is it possible to obtain a good overall view of the client and its activities using the service (possibility of monitoring, among other things)?

The assessment draws upon the following data sources: the FIN-FSA's RA and AIFMD data collections, the Bank of Finland's SIRA data collection, the FIN-FSA's annual capital markets survey and the FIN-FSA's registers.

## **2) Risk categories – geographical risk, clients and distribution channels**

In addition to products and services, the risk assessment must consider risk factors related to clients, geographical location and distribution channels.

The assessment of these risk factors draws upon the following data sources: the FIN-FSA's RA and AIFMD data collections, the Bank of Finland's SIRA data collection, the FIN-FSA's annual capital markets survey and the FIN-FSA's registers.

## **3) Management method categories**

In addition to risks, the risk assessment included an assessment of risk management methods. The firms have reported to the FIN-FSA on the management methods in the RA data collection. Furthermore, important information on applicable management methods was received in the authorisation and registration processes and from the firms' own risk assessments.

### 3 Risk assessment and its justifications

#### 3.1 Results of sector-specific risk assessment

The FIN-FSA has assessed the overall risk of money laundering in the sector as **Moderately Significant** and the risk of terrorist financing as **Less Significant**.

The risks of money laundering and terrorist financing were assessed separately only with respect to the risk categories. The methods of managing the risks of money laundering and terrorist financing were assessed as a whole, since they are similar from a high-level assessment perspective.

The risk of money laundering or terrorist financing risk cannot be eliminated entirely through management methods. Hence, the risk level of the risk categories was overweighted relative to the risk level of the management method categories in determining the overall risk of the sector.

The overall risk is calculated based on the risk levels of the risk categories and the risk management method categories. In the risk assessment, a risk score was determined for each risk and management method category. The common risk level of the risk categories is the rounded weighted average of the different risk categories' risk scores. The common risk level of the management method categories is the rounded average of the different categories' risk scores. The overall risk level is the weighted average of the risk scores, on a rounded basis, for the risk and management method categories.

The risk scores (1–4) corresponding to the risk levels determined for the risk and management method categories are shown in the tables below<sup>3</sup>:

#### Money laundering

Risk categories	Investment firms (53 firms)	Management companies (23)	Authorised AIFMs (19)	Registered AIFMs (93)
Products and services	2	2	2	1
Geographical location and payment traffic	1	1	1	1
Clients	2	2	2	2
Distribution channels	2	2	1	1
<b>Risk level of risk categories:</b>	<b>2</b>	<b>2</b>	<b>2</b>	<b>1</b>
Management method categories	Investment firms	Management companies	Authorised AIFMs	Registered AIFMs
Risk-based approach	3	3	3	3
Organisation of activities	2	2	1	2
Customer due diligence	2	2	2	3
Monitoring	3	2	3	3
<b>Risk level of management method categories:</b>	<b>3</b>	<b>2</b>	<b>2</b>	<b>3</b>
<b>Overall risk level</b>	<b>2</b>	<b>2</b>	<b>2</b>	<b>2</b>
<b>Overall risk level, entire sector</b>	<b>2</b>			

<sup>3</sup> The table only includes firms that reported numeric data.



## Terrorist financing

Risk categories	Investment firms	Management companies	Authorised AIFMs	Registered AIFMs
Products and services	1	1	1	1
Geographical location and payment traffic	1	1	1	1
Clients	1	1	1	1
Distribution channels	2	2	1	1
<b>Risk level of risk categories:</b>	<b>1</b>	<b>1</b>	<b>1</b>	<b>1</b>
Management method categories	Investment firms	Management companies	Authorised AIFMs	Registered AIFMs
Risk-based approach	3	3	3	3
Organisation of activities	2	2	1	2
Customer due diligence	2	2	2	3
Monitoring	3	2	3	3
<b>Risk level of management method categories:</b>	<b>3</b>	<b>2</b>	<b>2</b>	<b>3</b>
<b>Overall risk level</b>	<b>2</b>	<b>1</b>	<b>1</b>	<b>2</b>
<b>Overall risk level, entire sector</b>	<b>1</b>			

Less Significant = 1, Moderately Significant = 2, Significant = 3, Very Significant = 4

Sections 3.2 and 3.3 below review in more detail the justifications for each category's risk level in general.

## 3.2 Risk categories

### 3.2.1 Products and services

The products and services being provided have a crucial role for the risk of a sector or an individual entity to be abused in money laundering or terrorist financing. Hence, the risk category of the products and service was overweighted in determining the common risk level of all risk categories.

The most significant differences in the risks of money laundering concerning various financial instruments are due to the investment cycle and redemption possibilities. Also in assessing the money laundering risk concerning services, risks related to the financial instruments provided and used within them are emphasised.

In conclusion, it can be stated that financial instruments subject to public trading on a daily basis involve elevated risk of money laundering, since they are easily and quickly redeemable. The transmission and execution of orders as well as wealth management involve an elevated risk of money laundering. As regards these services, the risk is elevated among other things if the payer or the payee cannot be identified as well as circumstances where the service is part of a chain of orders consisting of several entities, which makes it more difficult to detect unusual transactions. In addition, the risk is elevated by difficulties in establishing an overall view of the origin of the client's funds.

According to the FIN-FSA's inherent risk assessment, there is elevated inherent risk of terrorist financing involved in products and services enabling the custody of funds so that they can be transferred readily from a person or service to another. In particular, this risk is involved in products and services enabling the cross-border transfer of funds almost in real time, and which allow the withdrawal of funds in cash. From the perspective of terrorist financing, there may also be elevated risk attached to products and services used in fund-raising purposes. The risk of terrorist financing related to products and services as described above is not elevated in the sector.

### 3.2.2 Geographical risk

The assessment of geographical risk considered, among other things, factors such as where services are provided and from which geographical regions payment transactions are received. The risk related to geographical location reflects the location of the firms' branches, subsidiaries, agents and distributors, and particularly the cross-border provision of services, if any.

Risk factors elevating the risk include non-EEA countries and particularly high-risk countries<sup>4</sup>.

The firms have only individual subsidiaries, distributors and agents outside the EEA. The firms provide some services outside the EEA, for example to Great Britain.

Although the customer due diligence obligations of the AML Act as such do not directly apply to the underlying investments provided by obliged entities, it should be noted that such investments may also involve an elevated risk of money laundering or terrorist financing or the risk of non-compliance with sanction regulations. The risk may be particularly elevated when the investments are located in a high-risk country.

### 3.2.3 Customer risk

In assessing customer risk, attention was paid among other things to the firms' number of PEP customers and other high-risk customers, foreign customers or customer connected to a non-EEA country. The firms have some customers in the abovementioned groups.

The number of high-risk customers reported by the firms was also compared to the number of wealth management clients, non-professional/professional clients as well as clients operating in certain high-risk sectors, and the firms' websites were also reviewed to find out what kind of clients the firms provide products and services.

According to information obtained through the RA data collection, there are differences among the firms in terms of how many clients they have determined as high-risk. The firms' own risk assessments suggest that a low number of high-risk customers in some firms may be due to their lack of appropriate procedures for the identification of high-risk customers.

According to the national risk assessment, the terrorist financing may be related, for example, to persons residing in or returning from conflict regions as well as radical Islamists or extreme right-wing supporters or factions. However, the data analysed does not imply that the risk associated with such persons entails an elevated risk for the customer base of the sector.

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<sup>4</sup>The FATF's high risk and other monitored jurisdiction countries and countries identified as high-risk by the European Commission. The FATF's list: <http://www.fatf-gafi.org/countries/#high-risk> The European Commission's list: [https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/anti-money-laundering-and-counteracting-financing-terrorism/eu-policy-high-risk-third-countries\\_en](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/anti-money-laundering-and-counteracting-financing-terrorism/eu-policy-high-risk-third-countries_en)

### 3.2.4 Distribution channels

The firms have a varying number of physical service locations. Non-face-to-face identification is used the most in investment firms and management companies. The firms have reported that they primarily apply a strong electronic authentication method to non-face-to-face identification.

The risk of money laundering and terrorist financing is increased where the distribution chain is complex and it is difficult for the entities to monitor client transactions. If the firms can only see part of the transaction chain, it is difficult to understand the client's operations. Where distribution channels are located in jurisdictions involving a higher risk of money laundering and terrorist financing, it also hinders the ability or monitor transactions.

The firms make varying use of agents and distributors. The firms' agents and distributors are supervised either by the FIN-FSA or another country's competent supervisor, or at least registered to such a supervisor. Not all these entities are obliged entities under the AML Act. However, each entity in the distribution chain has its specific and highly regulated role.

No distributors or agents were reported in high-risk countries and only a very limited number outside the EEA.

## 3.3 Management method categories

The purpose of this section on management methods is to form an understanding of the level of management methods for money laundering and terrorist financing risk in the sector.

The assessment of management methods is based on data reported by the firms themselves in the RA data collection. In addition, the assessment draws upon the FIN-FSA's experts, the firms' own risk assessments and information obtained in the authorisation and registration processes.

### 3.3.1 Risk-based approach

The risk-based approach means that firms identify, assess and understand the risks of money laundering and financing of terrorism to which they are exposed and take actions that are commensurate with the risks. Risk-based assessment also has an impact on customer due diligence actions and suspicious transactions detected in monitoring.

Responses to the RA data collection, information obtained in the authorisation and registration process as well as the firms' own risk assessments suggest that the risk-based approach to operations is not at an adequate level.

As an example of the shortcomings, some firms' own risk assessments failed to cover all areas required by the law. Products and services have not been assessed at a level of precision required to identify potential risk factors and determine the management methods. An example of an incomplete risk assessment, the group's companies only have a common risk assessment even though the group companies differ from each other in terms of clients, services and products.



The firms' own risk assessments must identify the ML/TF risk factors related to the firm's activities with respect to customers, countries, geographical areas, products and services as well as distribution channels and technologies. The impact of the risk factors must be assessed, the risk management methods in place must be described, and the impact of the management methods on the risk factors must also be assessed. The risk assessment must include a justified assessment regarding the residual risk (remaining risk) and whether the residual risk corresponds to firms' risk appetite or whether the firms should take necessary actions to mitigate the risk. The risk assessment must also demonstrate a connection with the customer due diligence policies.

### **3.3.2 Organisation of activities**

In the assessment of the organisation of activities, attention was paid to whether the functions to prevent money laundering and terrorist financing are organised as required by law and how they work in practice.

The firms have some shortcomings regarding for example the designation of responsible personnel.

### **3.3.3 Customer due diligence**

The assessment of customer due diligence focuses on compliance with customer due diligence obligations. The assessment reflects whether the firms have arranged processes related to customer due diligence as required by law (e.g. enhanced customer due diligence and related procedures) and, on the other hand, how the obligations are complied with in practice. The assessment draws upon the responses given in RA reporting as well as information obtained in the authorisation and registration process.

It has been detected in the authorisation and registration process that firms often have the incorrect notion that a mere copy of an identification document submitted by a client is an adequate method to verify the identity of the client or its representative.

The identification of the source of funds, and in particular, obtaining further clarifications on it emerged as another shortcoming. According to the EBA's risk factors guidelines, the close relationship in wealth management with the client facilitates the collection of information and thereby the formation of a fuller picture of the purpose and nature of the client's business. However, according to the EBA, a close relationship may also lead to conflicts of interests, thereby hindering the firm's intention to manage the risk of financial crime. This risk may manifest itself as a failure to identify the beneficial ownership or origin of funds.

The use of outsourcing or a third party in different customer due diligence tasks may improve efficiency and be customer-friendly. However, firms cannot be released through contractual arrangements from the liability for compliance with obligations provided in the AML Act. Based on the firms' own risk assessments and findings made in the authorisation and registration process, it can be stated that responsibilities and the allocation of duties related to customer due diligence (third party/outsourcing, group company/agent/distributor) are not always clear in the firms. When the responsibilities and the allocation of duties has not been determined clearly, the risk of money laundering and terrorist financing becomes elevated.

### 3.3.4 Monitoring

The section on monitoring assesses how ongoing monitoring of the customer has been arranged. In the assessment of monitoring, attention was also paid to the volume of suspicious transactions reported internally within the firms as well as the number of notifications submitted to the Financial Intelligence Unit.

As regards investment services, the examination of the source of funds and understanding the client's operation are important. Hence, the monitoring of transactions, client fund accounts and client behaviour as well as the verification of information in unusual or suspicious circumstances are important risk management methods.

Any suspicions concerning market abuse may also imply money laundering.

Based on the firms' responses to the RA data collection, there are monitoring shortcomings regarding the identification of suspicious transactions.

The firms have made few internal notifications or reports to the Financial Intelligence Unit of the Police on unusual/suspicious transactions.

## 4 Supervisory focus

Based on the sector-specific risk assessment, the focus of supervision will be redirected to management methods and in particular to how well the risk assessments made by the firms reflect the true risks of their activities and how they affect risk management.

The monitoring of customer transactions should also be developed. In particular, firms that have a short transaction cycle and provide products involving an elevated risk from the perspective of money laundering and terrorist financing must target clearly more ongoing monitoring at their clients than what they currently do.