

**EASTERN CARIBBEAN CENTRAL BANK**

**ANTI-MONEY LAUNDERING AND**

**COMBATING TERRORISM**

**AND PROLIFERATION FINANCING RISK BASED SUPERVISION**

**FRAMEWORK**



**EASTERN CARIBBEAN CENTRAL BANK**

**ST KITTS**

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## **LIST OF ACRONYMS**

<b>AML</b>	<b>Anti-Money Laundering</b>
<b>BCP</b>	<b>Basel Core Principles</b>
<b>CDD</b>	<b>Customer Due Diligence</b>
<b>CFT</b>	<b>Combating the Financing of Terrorism</b>
<b>CPF</b>	<b>Combating Proliferation Financing</b>
<b>ECCB</b>	<b>Eastern Caribbean Central Bank</b>
<b>ECCU</b>	<b>Eastern Caribbean Currency Union</b>
<b>FATF</b>	<b>Financial Action Task Force</b>
<b>LFI</b>	<b>Licensed Financial Institutions</b>
<b>MOU</b>	<b>Memorandum of Understanding</b>
<b>MMOU</b>	<b>Multi-lateral Memorandum of Understanding</b>
<b>ML</b>	<b>Money Laundering</b>
<b>PF</b>	<b>Proliferation Financing</b>
<b>TF</b>	<b>Terrorist Financing</b>



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**EASTERN CARIBBEAN CENTRAL BANK**  
**ANTI-MONEY LAUNDERING AND COMBATING TERRORISM AND**  
**PROLIFERATION FINANCING**  
**RISK BASED SUPERVISION FRAMEWORK**

**1.0 INTRODUCTION**

On 22 July 2016, the Monetary Council, at its 85<sup>th</sup> meeting took the decision to recommend to Member Governments that the legal responsibility for anti-money laundering and combating the financing of terrorism (AML/CFT) supervision and regulation of financial institutions licensed under the Banking Act (LFIs) be transferred to the Eastern Caribbean Central Bank (ECCB). The recommendation to designate the ECCB as the regulatory authority for AML/CFT for its licensees was necessary to address deficiencies relating to AML/CFT supervision that were cited in the Caribbean Financial Action Task Force Mutual Evaluation Reports. Additionally, there is a need to promote uniformity and consistency regarding the application of an AML/CFT supervisory framework to address some of these deficiencies.

In 2018, the ECCB implemented its Risk Based Supervision Framework for prudential supervision of its licensees. The Risk Based Supervision Framework describes the principles, concepts and core process which the ECCB utilises to supervise LFIs. In this regard the ECCB has strategised its mission to balance prudential supervision with AML/CFT supervision to ensure an integrated approach to supervision.

In keeping with its proactive approach to supervision, and in response to addressing new and emerging risks to the Eastern Caribbean Currency Union (ECCU), the ECCB periodically reviews its applied processes and procedures to ensure that it aligns with international best practices. Accordingly, and congruent with a dynamic risk environment, the ECCB has reviewed and revised its supervisory approach to ensure relevance to the current operating environment.

The revised anti-money laundering and combating terrorism and proliferation financing (AML/CFT/CPF) Supervision Framework includes:

- The AML/CFT legislation in Eastern Caribbean Currency Union (ECCU) member countries that transferred the regulatory and supervisory authority of AML/CFT for LFIs to the ECCB;
- The Multi-lateral Memorandum of Understanding (MMoU) between AML/CFT supervisory authorities in the ECCU for the purpose of providing a framework for cooperation in the supervision of LFIs and to implement an effective AML/CFT system for the financial institutions for which the Central Bank has regulatory responsibility;
- The implementation of the AML/CFT/CPF Risk-Based Onsite Examination Manual;
- Implementation of the money laundering, terrorist and proliferation financing (ML/TF/PF) Prudential Return;
- Implementation of the ML/TF/PF Risk Assessment Tool; and
- Partnership with key stakeholders to ensure ongoing training on AML/CFT/CPF emerging issues.

## **2.0 BACKGROUND AND RATIONALE**

The Financial Action Task Force (FATF) 2012 Recommendations seek to strengthen global safeguards and to further protect the integrity of the financial system, by providing governments with stronger tools to take action against financial crime. One of the most important changes was the increased emphasis on the Risk Based Approach<sup>1</sup>(RBA) to AML/CFT/CPF, particularly in relation to preventive measures and supervision. The Recommendations consider the RBA to be an 'essential foundation' of a country's AML/CFT/CPF framework. In October 2020, the FATF further revised Recommendation

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<sup>1</sup> A RBA to AML/CFT means that countries, competent authorities and financial institutions are expected to identify, assess and understand the ML/TF/PF risks to which they are exposed and take AML/CFT/CPF measures commensurate to those risks in order to mitigate them effectively (FATF Guidance for a Risk Based Approach October 2014).



1, requiring countries and private entities to identify, assess, understand and mitigate risks associated with proliferation financing.

To this end, the Central Bank's risk based supervision framework has been amended to include the supervision of proliferation financing (PF). The revised framework is guided by the FATF Guidance on Proliferation Financing Risk Assessment and Mitigation, and sets the foundation to assess the adequacy of applied systems at LFIs for the identification, assessment and reporting of PF risks.

The RBA to supervision not only conforms with FATFs recommendations, but allows for a more effective supervisory approach to AML/CFT/CPF in the ECCU. The RBA is not a "zero failure/zero tolerance" approach and does not exempt the supervision of LFIs' considered to possess a low risk of ML/TF/PF in the ECCU. It facilitates greater monitoring and supervisory resource allocation for those LFIs' with higher ML/TF/PF risks.

### **3.0 SUPERVISORY APPROACH AND PRINCIPLES**

The ECCB's supervisory approach to AML/CFT/CPF is risk based and is premised on the concepts and principles considered by the FATF and the Basel Core Principles. The RBA to AML/CFT/CPF complements the ECCB's approved prudential Risk Based Supervisory (RBS) Framework for LFIs which includes the following:

1. **Continuous Assessment of the ML/TF/PF risk profile for LFIs-** the RBA framework requires the LFI's risk profile to be current. This necessitates ongoing examination and offsite monitoring. Supervision requires establishing an on-going relationship with LFIs. A relationship manager is assigned to each territory and all LFIs in that territory.
2. **Principles-based and forward looking-** the RBS framework is principles-based and forward looking which will permit a timely and flexible response to the advances in the financial sector as well as early identification of risks and timely intervention. Principles-based supervision applies sound judgement in identifying

and evaluating risks to the effectiveness of the supervisory approach and distinguishes the complexity as well as diversity among the LFIs avoiding a '*one size fits all*' approach.

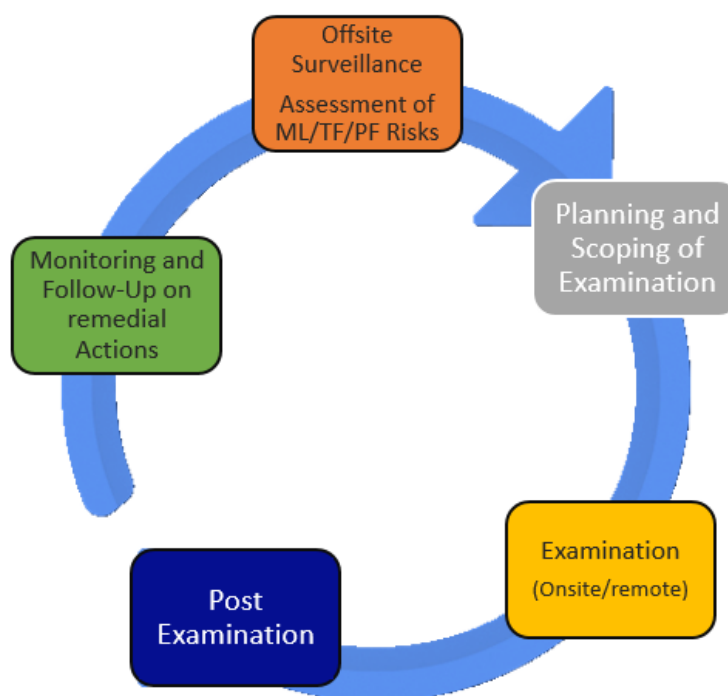
3. **Supervisory Intensity**- there is a direct link between a LFI's overall risk profile assessment and the level of supervision. The level/intensity of supervision will depend on the risk profile of the LFI.
4. **Focusing on areas of high risk**- ML/TF/PF risk assessment focuses on material risks. It assesses both current/actual risks and potential risks. Supervisors are expected to use sound judgement, based on evidence and analysis, in the risk identification and assessment process. In this regard use of information from the National Risk Assessment for the specific country will assist the ECCB in understanding the overall country risk and specifically the risk to the financial sector which will ultimately inform the ECCB's risk assessment of LFIs.
5. **AML/CFT/CPF Governance**- the RBA framework recognises that the Board of Directors (the board) must provide effective corporate governance with the support of senior officers. The board and senior officers are primarily responsible and ultimately accountable for the LFIs' compliance with applicable AML/CFT/CPF legislation and supervisory guidance. In this regard, the ECCB has implemented its five (5) pillar approach to assessing AML/CFT/CPF Governance at LFIs (*see section 4.1*). The board and senior officers are expected to be proactive in providing the ECCB with timely response/notification of AML/CFT/CPF matters affecting the LFI.

Consistent with the RBA framework, the ECCB utilises a dynamic and effective process to guide its LFI supervisory work on an ongoing basis. The ECCB Risk Based AML/CFT/CPF Supervisory process constitutes the following elements:

1. Offsite surveillance (ML/TF/PF Risk Assessments);
2. Planning and Scoping of examinations based on ML/TF/PF Risk Profile;

3. Examinations (onsite, remote, or a hybrid);
4. Post Examination assessment and revision of ML/TF/PF Risk Profile; and
5. Monitoring and follow-up of remedial action and supervisory action plans.

**Fig. 1 Risk- Based AML/CFT/CPF Supervision Process**



Each step highlighted above utilises documented products to facilitate communication, reporting and coordination. The supervisory process is not sequential. Updating of the ML/TF/PF risk assessment for LFIs is a continuous process, however ML/TF/PF risk assessments will be reviewed quarterly at a minimum.

To facilitate the process, the ECCB Risk Based AML/CFT/CPF Supervisory framework constitutes two core elements: offsite surveillance and examinations.

#### **4.0 OFFSITE SUPERVISION**

The primary objective of AML/CFT/CPF off-site supervision is to assess the overall adequacy of LFIs systems and processes to manage their ML/TF/PF risks. The off-site

supervision activities are ongoing and assess the ML/TF/PF risks and compliance of the LFIs. The AML/CFT/CPF off-site supervision relies on prudential information submitted by LFIs and is intended to assist the ECCB in the development of a preliminary ML/TF/PF risk rating of LFIs. Risk factors emanating from offsite supervision shall be considered in executing a risk-based approach in planning the scope for an on-site examination.

The offsite supervision allows the ECCB to:

1. Understand the ML/TF/PF Risks in each LFI through the conduct of a ML/TF/PF risk assessment;
2. Identify AML/CFT/CPF shortcomings or areas of non-compliance with legislative or regulatory requirements;
3. Develop supervisory action plans.

The following are the various areas within the offsite surveillance framework:

1. Assessment of AML/CFT/CPF Governance Structure, utilising the ECCB five pillar approach (*see section 4.1*) to AML/CFT/CPF governance;
2. Conduct of a ML/TF/PF Risk Assessment, utilising information from the ML/TF/PF Prudential Return (PR14) and risk focused information submitted by LFIs;
3. Review of previous on-site examination reports and follow-up on outstanding remedial actions;
4. Conduct media surveillance for emerging ML/TF/PF risks and changes to legislation; and
5. Coordination with national regulators in the ECCU under the MMoU for cooperation on AML/CFT/CPF matters.

#### **4.1 ECCB Five Pillar Approach to AML/CFT Governance**

The success of the AML/CFT/CPF program depends on a strong governance structure which includes company-wide commitment to a culture of compliance. The ECCB's five pillar approach to AML/CFT/CPF governance constitutes the following:

**Pillar 1- AML/CFT/CPF Risk Management Framework-** LFIs must develop and implement a risk framework for the identification, measurement, reporting and monitoring of ML/TF/CPF risks. LFIs must have a clear understanding of ML/TF/PF risks to which the institution may be exposed and implement measures to mitigate the risk. As part of this process LFIs are required to conduct a periodic ML/TF/PF self-assessment for the institution.

Clear policies and procedures, and measures for adherence to the policies and procedures must be approved by the board and implemented by LFIs. The culture of compliance must be established at the top. As a result, the board must ensure that its views on the importance of the AML/CFT/CPF compliance is clearly communicated across all levels within the institution. Incumbent on this is the development of ML/TF/PF risk appetite statement and tolerance levels, which guide the development and implementation of the risk based AML/CFT/CPF compliance program.

The three lines of defense play a critical role in the ML/TF/PF risk management process.

- a. **The first line of defense-** owns and manages risks in the LFI. Operational management is responsible for planning, directing and controlling the day-to-day operations of the LFI's activities/business to ensure compliance with approved policies and processes. Operational management should detect and prevent material errors, irregularities, weaknesses and take action in a timely manner.
- b. **The second line of defense-** LFIs should have in place a separate oversight function depending on the nature, size and complexity of their business. Risk Management and Compliance functions are considered as the second line of defense and are responsible for providing independent oversight of the AML/CFT/CPF function. Risk Management and Compliance functions are responsible for the development and implementation of the internal control and risk systems, provide

independent oversight of the LFI's compliance with laws, regulations and guidelines and facilitate and monitor the implementation and effective risk management practices by Operational Management.

- c. **The third line of defense-** Internal Audit provides independent oversight of the effectiveness and adherence of the LFIs procedural controls. Internal Audit must review the AML/CFT/CPF compliance program for adequacy and reasonableness.

**Pillar 2- Compliance Officer and Staffing-** The board must appoint a Money Laundering Reporting Officer (MLRO) and/or Compliance Manager with the necessary experience and skillset to oversee the LFI's day-to-day AML/CFT/CPF compliance programme. Notification of such designation must be made to the ECCB<sup>2</sup>. LFIs are required to submit curriculum vitae of the Compliance Manager and key AML/CFT/CPF officers for assessment by the ECCB. The assessment of the Compliance Officer forms part of the ECCB's ML/TF/PF risk assessment for LFIs.

**Pillar 3- Internal Controls-** A system or structure of internal controls must be in place at each LFI. That system, based on the results of an ongoing ML/TF/PF risk assessment, creates the framework for an effective compliance program and is documented in a policies and procedure manual. The framework should include, but not be limited to, policies and procedures for: customer identification; monitoring for suspicious activities, dual control and segregation of duties, reporting, responding to law enforcement, record retention and destruction, periodic reviews for high risk accounts, independent testing, and training.

**Pillar 4- Training-** The frequency of the AML/CFT/CPF training programme should at a minimum be aligned to regulatory requirements. The training must be tailored to the role and function of the employee and should be periodic. LFIs must

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<sup>2</sup> As at 31st December 2021 this is applicable in the following ECCU member countries: Antigua and Barbuda, Commonwealth of Dominica, Grenada, Saint Lucia and St Vincent and the Grenadines

institute board and senior management specific training to keep abreast of changing trends in ML/TF/PF. Specialised training and certifications must be allowed for MLRO/ Compliance Officers and other staff, as appropriate. LFIs are required to document training attendance and materials.

**Pillar 5- Independent Assessment-** The frequency of independent reviews will be determined by the risk profile of the LFI based on its ML/TF/PF self-assessment. Independent audits can be conducted by the Internal Auditor or by a suitably qualified external party. The scope of the independent review should include but not be limited to:

- Review of the ML/TF/PF risk self-assessment;
- Transaction testing to verify adherence to CDD, reporting and recordkeeping;
- Review of the monitoring systems;
- Testing of processes to identify unusual activity;
- Evaluation of adequacy of human and other resources;
- Determination of the adequacy of training materials and record retention;
- Assessment of management's efforts to remediate previously identified issues; and
- Evaluation of the overall adequacy and effectiveness of the AML/CFT/CPF compliance program.

LFIs must develop specific action plans to resolve identified issues, assign ownership, and track findings through to resolution.

The five pillars of governance assigned compliance ratings of **compliant, largely compliant, partially compliant and non-compliant**. See table 1 below for ratings descriptions.

**Table 1- AML/CFT/CPF Governance Compliance Ratings**

<b>Compliance Ratings</b>		<b>Description of Rating</b>
Compliant	<b>C</b>	There are no shortcomings
Largely Compliant	<b>LC</b>	There are only minor shortcomings
Partially Compliant	<b>PC</b>	There are moderate shortcomings
Non-Compliant	<b>NC</b>	There are major shortcomings
Not applicable	<b>NA</b>	A requirement does not apply, due to the structural, legal or institutional features of a licensed financial institution

#### **4.2 ML/TF/PF Prudential Return**

The Prudential Return (PR14) gathers information specific to money laundering for LFIs and it forms part of the overall ML/TF/PF risk assessment of the ECCB. The submitted data will assist the ECCB in identifying and assessing the ML/TF/PF risk related to products and services, types of customers and entities, delivery channels and geographic risks to each LFI.

LFIs are required to submit the PR14 quarterly to the ECCB via the Statistical Analysis Software (SAS) database. Details on the completion of the PR14 is captured in the ECCB's Manual of Instructions.

#### **4.3 ML/TF/PF Risk Rating Tool**

The ML/TF/PF risk assessment tool utilises information gathered from the PR14 to assist the ECCB in the development of a preliminary ML/TF/PF risk rating for LFIs. The tool utilises both quantitative information from the PR14 and qualitative information derived from the submission of risk focused information or findings from previous onsite examinations and other competent authorities. The tool facilitates the assessment of two major categories:



1. **The Governance Framework:** The focus of AML/CFT/CPF regulation is not only on the setting of specific requirements and thresholds but also to determine the effectiveness of the LFIs' AML/CFT/CPF governance framework and its implementation /execution by:

- Understanding the LFI risk profile; and
- Ensuring a risk based approach to control by assessing:
  - The nature and extent of internal controls;
  - The scope of independent testing;
  - The skills and expertise required of the MLRO/compliance officer; and
  - The focus of and approach to training.

2. **The inherent risk based on product and services, customers and entities and geographies-** the identification of ML/TF/PF risk of a LFIs' products and services, customers and entities, and the geographic locations are the first step in understanding the ML/TF/PF risk profile for the LFI. This process is iterative given the changing landscape of banking, where new technologies are developed and the associated risks are often unknown. These risks have the potential to affect not only inherent risk but also the control framework. In this regard, the ECCB will consider the following:

- How does the new product or service affect the LFIs ML/TF risk profile?
- Has the LFI taken the necessary steps to mitigate the risks identified?

## **5.0 ML/TF/PF RISK ASSESSMENT RATINGS OF LICENSED FINANCIAL INSTITUTIONS**

The results of the ML/TF/PF risk assessment produce a ML/TF/PF risk rating assigned to the LFI. The net risk for each category will be a function of the aggregate level of inherent ML/TF/PF risk offset by the aggregate level of quality of risk management. In conducting the ML/TF/PF risk assessment the ECCB must ensure that all possible products, services, customers, entities, transactions, and geographic locations were

considered and that sufficient detailed analysis within these specific risk categories is conducted.

The ML/TF/PF risk assessment tool generates a risk rating of (**low, moderate, above average and high**) in relation to the aggregate level of inherent risk and quality of risk management for products and services, customers and entities and geographies. Ratings for governance (**compliant, largely compliant, partially compliant and non-compliant**) are further aggregated to produce the overall ML/TF/PF risk rating.

**Table 1- ML/TF/PF Risk Ratings**

Governance Ratings	Exposure to Inherent Risk Rating			
	Low	Moderate	Above Average	High
	ML/TF/PF Risk Rating			
Compliant	Low	Low	Moderate	Above Average
Largely Compliant	Low	Moderate	Above Average	High
Partially Compliant	Moderate	Above Average	High	High
Non-Compliant	Above Average	High	High	High

**6.0 ONSITE SUPERVISION**

The ECCB’s process for the conduct of a risk based AML/CFT/CPF examination is detailed in the Risk Based AML/CFT/CPF Onsite Examination Manual and Remote Examination Procedures for Supervisors (the manual). The manual describes the fundamental procedures used in performing an onsite examination for AML/CFT/CPF, including the application of remote examination practices, where applicable.

The examination scope is guided by the ML/TF/PF risk profile and risks of the specific LFI. The ECCB will dedicate resources to areas considered to be of high risk or where risk management processes exhibit significant weaknesses. At its discretion, the ECCB will

commission a full scope AML/CFT/CPF examination to include an assessment of all core AML/CFT/CPF examinations areas.

### 6.1 Examination schedule

The risk rating applied to the LFI determines the frequency of supervisory engagement, such as examinations<sup>3</sup>, remedial action and prudential visits. The matrix below provides the examination cycle for LFIs based on assigned ML/TF/PF risk ratings. The ECCB can determine a higher frequency of examinations based on ML/TF/PF developments at the institution or within country.

**Table 2- Examination Schedule**

<b>COMPOSITE ML/TF/PF RISK RATING</b>	<b>DESCRIPTION</b>	<b>MINIMUM EXAMINATION FREQUENCY</b>
<b>LOW</b>	Measures to combat money laundering, terrorist financing and proliferation financing at the financial institution are considered strong. There is a high level of effectiveness with the applied AML/CFT/CPF Compliance Program with only minor improvements required.	<b>ONCE EVERY 36 MONTHS</b>
<b>MODERATE</b>	Measures to combat money laundering, terrorist financing and proliferation financing at the financial institution are considered satisfactory. There is a substantial level of effectiveness with the applied AML/CFT/CPF Compliance Program with only moderate improvements required.	<b>ONCE EVERY 24 MONTHS</b>
<b>ABOVE AVERAGE</b>	There are some weaknesses in the measures to combat money laundering, terrorist financing and proliferation financing at the financial institution. There are significant deficiencies in the AML/CFT/CPF Program which results in a moderate level of effectiveness.	<b>ONCE EVERY 18 MONTHS</b>

<sup>3</sup> Examinations can be conducted face-to-face or remotely.

<b>COMPOSITE ML/TF/PF RISK RATING</b>	<b>DESCRIPTION</b>	<b>MINIMUM EXAMINATION FREQUENCY</b>
<b>HIGH</b>	Measures to combat money laundering, terrorist financing and proliferation financing at the financial institution are weak which can potentially result in a significant loss to the institution. There is a low level of effectiveness with the applied AML/CFT/CPF Compliance Program with fundamental improvements required.	<b>ONCE EVERY 12 MONTHS</b>