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Inclusive AML-CFT models in Africa

Lessons from six financial service providers

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Executive summary

Study objective and background. This study set out to develop and apply inclusive compliance models in anti-money laundering and combatting the financing of terrorism (AML-CFT) to assist country and institutional stakeholders in achieving inclusive integrity outcomes. An inclusive compliance model is a compliance approach that minimises the cost of compliance while still adequately managing risks of money laundering and financing of terrorism (ML-FT). Thus, inclusive compliance models enable financial institutions to proportionately allocate resources in a way that advances financial inclusion and drives implementation of risk-based approaches. Developing an inclusive compliance model requires an understanding of the *cost of compliance* together with the *risk* of the customer. Little has been published around how companies approach compliance with AML-CFT and the related costs and risk profiles of customers in Africa.

Methodology. The research team worked with six institutions in three countries (Ghana, Kenya and Mozambique) to understand their cost of compliance related to ML-FT, compared to the risk profile of their customers. This involved specifying a "base-case" model to calculate the current cost of compliance across a number of cost drivers. The base case was then compared to different potentially viable alternatives to current AML-CFT practices to reduce costs while still driving compliance and inclusion.

Key findings

National risk-based approaches to AML-CFT still rules-bound. All institutions are required to apply a risk-based approach that complies with country-level AML-CFT obligations, which in turn must be aligned with international standards. However, most country AML-CFT obligations in Africa are still articulated in terms of a set of rules to comply with, leaving little flexibility to a financial institution on how it allocates resources to mitigate ML and TF risks. As a result of the rules that are imposed, the risk-based approaches of countries also provide limited room for using alternative AML-CFT measures that are more effective and more efficient. A rules-based approach furthermore tends to focus the resources of financial institutions on mitigating compliance risk rather than ML-TF risk.

Client ML-TF risk classification and risk mitigation underdeveloped. Where financial institutions do apply risk assessment frameworks, the efficacy thereof is limited because the frameworks employed for risk assessment processes tend to classify almost all clients as low risk, sometimes up to 99% of the client base. The biggest source of the inaccuracy of the risk assessment frameworks is due to its macro-level approach to risk classification of clients. Rather than understanding the ML-TF risk profile of each individual client, the risk-assessment of clients is based on group characteristics.

Cost of compliance with AML-CFT obligations constitute a sizeable proportion of operating expenditure. The base-case model yielded an annual cost of compliance of USD403,740. Figure 1 below illustrates the cost of compliance per AML-CFT activity – the percentages indicate the relative size of each activity. This amounted to 4.1% of total operating expenses.

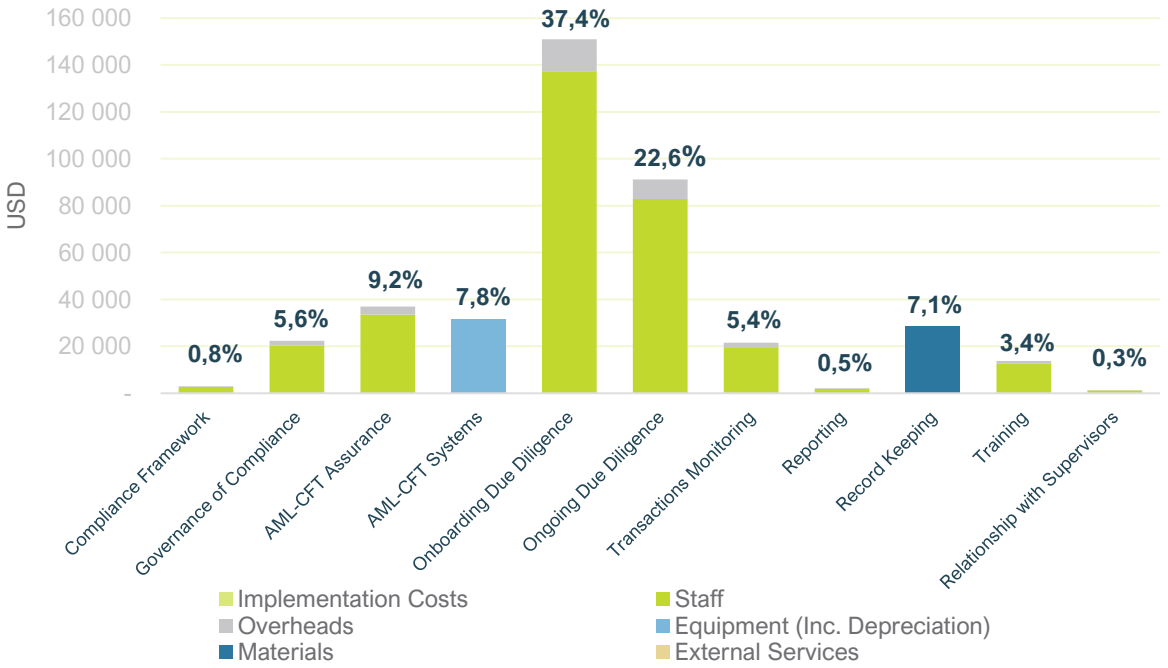

Figure 1: Base-case model for cost of AML-CFT activities (annual)

Source: Project base-case scenario

Compliance effort and resources disproportionally spent on lower-risk clients. Approximately 60% of all cost-of-compliance resources are dedicated to activities that relate to customer due diligence, which is the main ML-TF risk mitigation strategy employed in a rules-based approach to AML-CFT. With most clients rated as low risk, the implication is that most of the AML-CFT resources are spent on lower-risk clients.

A risk-based approach necessary for improved ML-TF risk mitigation and proportionality. The modelling of the cost of compliance based on identified AML-CFT activities yielded the following insights:

- ***Proof of address flexibilities (including removal) will save cost without compromising risk mitigation.*** Costs relating to proof-of-address measures are significant. It constitutes 60% of the total CDD cost of compliance. The lack of verifiability in the African context and susceptibility to fraud make proof of address an ineffective ML-TF risk mitigation measure. Removing proof of address will reduce the cost of compliance with AML-CFT obligations by approximately 39%.
- The digital automation of AML-CFT processes will improve proportionality of risk mitigation strategies only if regulation allows. For financial institutions to benefit from the efficiency gains of AML-CFT systems, regulatory regimes must move towards a more flexible, principles-based approach. In such an environment, more time will be spent on transaction monitoring and reporting to the AML-CFT authorities. The ML-TF risk mitigation emphasis will change from identifying clients to understanding their transaction profiles. Therefore, the distribution of resources will be more closely related to the inherent risk of the client. However, the modelling exercise showed that the cost of compliance will increase by almost 25% if a rules-based approach remains in place, without any risk mitigation benefit due the use of AML-CFT systems.

Key actions

AML-CFT regimes centred on outcomes, based on a deeper understanding of risk.
The attachment to legacy rules-based AML-CFT regulations stems from a misunderstanding of risk. The stakeholder workshops conducted during the study highlighted a number of misperceptions that exist regarding the risk-based approach (see Section 3.1.1). These misperceptions drive, to a large extent, the mitigation of *compliance risk* and not ML-TF risk. What is needed is a shift in focus. Under current AML-CFT regimes, risk is assessed and mitigated by focusing on **inputs** such as documentation, whereas the emphasis should be on **outputs** such as lower inherent risk – which place an ongoing focus on AML-CFT outcomes. Therefore, regulators need to adopt a more principles-based approach to AML-CFT obligation to allow financial institutions the flexibility to focus their risk mitigation strategies according to ML-TF risk and not compliance risk. Furthermore, the need to enable digital inclusion to support social distancing is now an imperative. Regulatory and institutional approaches that focus on outcomes will allow faster adaptation during times of crisis, while managing risks more effectively and ensuring continued AML-CFT outcomes.

Inclusive compliance models to manage risk and achieve inclusive integrity objectives.
The effective use of resources is paramount to effectively combatting ML-TF risk, including the associated ML-TF risk of financial exclusion. Firstly, this requires improving current risk assessment frameworks employed by financial institutions to enable more accurate risk categorisation of clients. Secondly, financial institutions should gain a greater and more granular understanding of the cost of AML-CFT activities to enable a proportionate approach to ML-TF risk mitigation. If AML-CFT resources are allocated proportionally to the risk, it will benefit financial inclusion, reducing national-level ML-TF risk. This calls for a redesign of financial institution AML-CFT processes and the change of board-level perspectives to ensure a more proportional, and therefore, inclusive approach.

1. Introduction

Objective. The objective of the study was to develop and apply inclusive compliance models to assist country and institutional stakeholders in achieving inclusive integrity outcomes[1]. Inclusive compliance models enable financial institutions to proportionately allocate resources in a way that advances financial inclusion and drives implementation of risk-based approaches. It requires an understanding of the cost of compliance together with the risk of the customer. When the cost of AML-CFT compliance is unnecessarily high, entry-level consumers will be inappropriately affected. Higher cost of AML-CFT compliance causes fees associated with the account to rise and thereby making it unaffordable for low-income individuals. Such cost is often difficult to justify once the risk of the customer is understood. It may also displace investment in higher-risk categories resulting in greater spend on compliance, but overall lower achievement of risk management.

Background on the need for inclusive compliance models. In many of the African AML-CFT contexts, regulators and supervisors are taking a zero-risk tolerance approach to ML-TF risks by applying a strict rules-based approach to their AML-CFT regime. For example, the inability of most Africans to prove their address[2] – which is a requirement to open a bank account – means that they are necessarily excluded from the banking sector. At international level, there is an increasing appreciation that financial integrity and financial inclusion objectives are complementary[3]. As a response to the mandated risk-based approach, institutions and regulators now need to improve their approaches and tools to better understand and manage risk. Inclusive compliance models provide a cost-benefit approach to assess current risk mitigation strategies and change the approach to invest resources where the risk lies.

Rationale for the study. A thorough understanding of compliance costs will assist financial institutions in proportionately allocating resources in a way that advances financial inclusion and the risk-based approach in general. Desktop research revealed little quantitative information available regarding the cost of AML-CFT compliance, indicating a clear need for further research on this topic. When the cost of AML-CFT compliance[4] is unnecessarily high, entry-level consumers will be disproportionally affected. Higher cost of AML-CFT compliance results in fees associated with accounts to rise and thereby making it unaffordable for low-income individuals. On the other hand, where the cost of AML-CFT compliance is low, the affordability barrier for financial inclusion is lower. This will have favourable inclusive integrity outcomes.

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1 Aligning financial inclusion and financial integrity (inclusive integrity) refers to the implementation of effective and proportionate AML-CFT and National Financial Inclusion Strategies (NFIS) regimes that advance the financial inclusion and financial integrity agenda. This can only be successful if the policy objectives of financial inclusion and financial integrity are viewed as mutually reinforcing, and if the pursuit of one does not adversely affect the other.

2 From consumer surveys we know that 61% of adults in Nigeria, 89% of adults in Tanzania, and 88% of adults in Uganda, is unable to reliably prove their residential address. For more information see https://cenfri.org/articles/proof-of-address-must-fall/

3 In this regard, specific reference is made to the Toolkit on Aligning Financial Inclusion and Anti-Money Laundering and Countering the Financing of Terrorism that was developed in conjunction with the Alliance for Financial Inclusion (AFI). The AFI Global Standards and Proportionality Working Group (GSPWG) collaboratively developed a toolkit with Cenfri (the Centre for Financial Regulation & Inclusion). Compliance & Risk Resources provided inputs into this toolkit.

4 The cost of AML-CFT compliance is, to a large extent, a function of the applicable regulatory obligations and supervision thereof, as interpreted by institutions in light of guidance that is available.

Approach. The research team worked with six institutions in three countries (Ghana, Kenya and Mozambique) to understand their current cost of compliance related to ML-FT compared to the risk profile of related customers. To assess compliance costs, the team developed an activity-based costing model[5] to explore key cost-of-compliance themes relating to entry-level accounts, including scenarios to drive inclusion at a similar or stronger level of compliance. This was provided to participating institutions together with a request for information that was designed to obtain AML-CFT cost data and ML-TF risk. Financial institutions also provided the research team with their client ML-TF risk assessment frameworks to allow analysis of the robustness of their client risk classification. Facilitated workshops with financial institutions and AML-CFT supervisors were conducted to obtain the inputs for the study.

The report is structured as follows:

- ***Section 2 – Research methodology:*** This section contains a description of the research methodology used to engage with financial institutions to obtain input to analyse their respective risk assessment frameworks and to estimate their cost of compliance with AML-CFT regulation.
- ***Section 3 – Insights from Insights from inclusive*** compliance models: This section contains the insights from the analysis conducted for this project. The first sub-section, on risk assessment, highlights the key principles for designing risk assessment frameworks and provides commentary on some of the common misconceptions that are prevalent relating to the assessment of AML-CFT risks. The second sub-section contains a costing analysis that is based on the implementation of the project costing methodology at financial institutions. The third sub-section contains a scenario analysis to illustrate some of the potential cost-savings strategies available to financial institutions, depending on internal protocols and an enabling regulatory environment.
- ***Section 4 – Conclusion***

  This document distils insights from a detailed cost-of-compliance modelling exercise conducted with six financial institutions in Africa, making it the first study to document actual costs of AML-CFT compliance across different cost drivers in Africa. In so doing, it puts into stark relief the implications of the largely still rules-based AML-CFT regulations and compliance practices on the continent, where the emphasis is on the inputs (in terms of documentation and compliance procedures) required to manage risk, rather than the risk outcomes to be achieved.

  Moving towards a risk-based approach that will achieve the objective of inclusive financial integrity requires the development of more inclusive compliance models based on a deeper understanding of risk as well as cost drivers, and with more flexibility to apply resources towards the management of risk in the most cost-effective way.

  While (in principle) there may be buy-in to move towards such an approach, there is still much ground to be covered in developing the processes, systems and people controls needed to implement an effective risk-based approach. Indications are that institutions are still on a learning curve. Thus, there will be value in providing technical support that leverages sound risk principles to the advantage of AML-CFT outcomes, and in building industry-level support for the development of an approach that is suitable for local circumstances. This will reduce the learning curve and enhance the effectiveness of the AML-CFT regime.

5 Activity-based costing is a costing method that identifies activities in an organisation and assigns the cost of each activity to all products and services according to the actual consumption by each.

- **Recommendations*.*** The report concludes with a write-up of key cost-of-compliance points for consideration going forward.

The Annexures to this report elaborate on key insights into the costing methodology and models that have been applied.

2. Research methodology

The study aimed to answer two questions:

- ***What is the current state of inclusive compliance models?*** Answering this question entails understanding the types of compliance activities conducted by financial institutions, how much each activity cost and understanding the risk sensitivity of the various approaches.
- ***Which viable alternatives are possible to reduce costs while driving compliance and inclusion?*** Answering this question entails understanding the potential for increased efficiencies in the compliance approaches without undermining its effectiveness.

Evidence to shape the study and address the core research questions came from a literature review as well as from data gathered during workshops with six providers in three African countries. The research team developed a tool to assess the current cost related to AML-CFT compliance activities. The development of the tool was informed by existing literature and stakeholder engagements. From the engagements with financial institutions, a base-case scenario was constructed to illustrate the cost of compliance based on the AML-CFT activities that institutions employ. To unpack the impact of alternative risk mitigation approaches, the research team analysed a couple of scenarios to assess what could be done to improve inclusive compliance models.

2.1. Desktop research and literature review

Literature review. A scan of the literature made it clear that, even though cost of compliance has received attention, little quantitative analysis has been published. Particularly two studies were useful in framing the point of departure for this study. Firstly, a FinMark Trust AML-CFT regulatory requirements pre-implementation study of a risk-based approach provides high-level insights into the cost of compliance when a country moves away from rules-based AML-CFT law to a principles approach to the regulation of AML-CFT. It indicates that there are often high upfront systems and other implementation costs in the development of risk-based approaches that may be offset by relatively low ongoing AML-CFT related costs where principles-based legislation allows for the achievement of AML-CFT objectives in a flexible and efficient manner (FinMark Trust, 2016). Secondly, a European Union publication describes an approach for undertaking a cost-of-compliance analysis relating to AML-CFT measures that are applied by financial institutions (Europe Economics, 2009). These publications have been considered in the design of the study methodology.

2.2. ICM tool development

Costing model. The costing model was developed using MS Excel. The model was designed to facilitate the identification of AML-CFT cost drivers and activities relating thereto. The approach allows for the analysis of the allocation of resources in relation to AML-CFT measures and for the costing thereof.

AML-CFT compliance activities. Activities that form part of an institution's AML-CFT programme were identified by the project team and were tested with institutional stakeholders. These include the following:

- **Compliance framework.** A compliance framework provides the structuring of governing and compliance activities. It typically consists of an AML-CFT policy, charter, manual and ML-TF risk management and compliance programme.
- **Governance of compliance.** The governance of compliance resides with the board of directors. Compliance activities include governance processes such as preparation for and attendance at governance committee meetings.
- **AML-CFT assurance.** There are three lines of defence in the provision of assurance relating to AML-CFT, which encompasses management processes, compliance monitoring, and internal auditing.
- **AML-CFT systems.** This relates to the acquisition and maintenance of systems that contribute to the adhering to AML-CFT obligations and the management of ML-TF risk.
- **Onboarding due diligence.** Where CDD processes are largely manual, staff members spend time undertaking the client acceptance processes. This relates to CDD and includes time spent on identification, verification and screening of new clients as well as the support processes relating thereto.
- **Ongoing due diligence.** In largely manual, paper-driven processes, CDD is periodically reviewed to ensure that the information obtained during onboarding is still accurate and that the risk classification of clients is still appropriate.
- **Transactions monitoring.** In a risk-based approach, institutions are expected to monitor client transactions to establish whether they are in line with the expected transaction profile for clients.
- **Reporting.** Reporting requirements relate to unusual and suspicious transactions, cash threshold requirements, currency reports and any other reporting required in terms of regulatory obligations.
- **Record-keeping.** Institutions must keep records in terms of AML-CFT obligations relating to due diligence, transactions monitoring, reporting, training and other matters as appropriate.
- **Training.** Generic and specific training of staff members is required to assist them to discharge their AML-CFT compliance obligations.
- **Relationship with regulators and supervisors.** The compliance function assists management in managing the relationship with regulators and supervisors.

Refer to *Annexure 2: AML-CFT activities* for a more detailed description on the compliance activities listed above.

Cost categories. The costing methodology that was utilised in engaging with project stakeholders has been developed with reference to the OECD Regulatory Compliance Cost assessment guidance (2014). The following cost categories have been identified in this regard (see Annexure 3: Compliance cost categories for more details):

- **Implementation costs.** When regulatory requirements are brought into effect, costs will be incurred in preparations that are made for compliance with the regulatory obligations and in developing and implementing a framework and process for AML-CFT compliance.
- **Staff costs.** Staff costs may be direct or indirect and will be incurred by the first, second and third line of defence staff. Direct costs are reflected in this item, and indirect costs are allocated in the following cost category.

- **Overheads.** Costs will be incurred in support of the activities undertaken by staff members and maintaining systems. Such costs may include premises costs, indirect equipment costs, electricity and water and other utility costs, indirect staff costs and other costs that cannot be directly allocated to AML-CFT measures that are undertaken.
- **Equipment.** Equipment may include computer systems, software and machines. Equipment costs are classified as capital expenditure where there is an enduring benefit therefrom and depreciation will be charged to the income statement periodically.
- **Materials.** Costs may be incurred to acquire materials that are needed for AML-CFT compliance. Such materials could include documentation required to comply with regulatory requirements as part of business processes and training materials needed to train staff.
- **External services.** These costs relate to the services of external consultants that may be needed to provide guidance and assist in the development of a compliance framework and process.

2.3. Workshops

Data collection. The data inputs required for completing the costing methodology were obtained by means of a day-long, facilitated workshop with each participating financial institution. In one case, the inputs were obtained via a series of web calls rather than a face-to-face workshop. Numerous follow-up calls were made to obtain clarification or further information where needed. During the workshops, financial institutions provided the research team with the necessary information to cost the AML-CFT compliance activities that are relevant. The information provided by stakeholders was in the form of high-level time and cost estimates from compliance and management representatives and was not based on actual time and motion studies.

Risk assessment frameworks. Since risk classification is an important cost driver in the CDD process, the project team obtained copies of the risk assessment frameworks of institutions for review purposes. This provided insights into the risk assessment approach that is adopted in different institutions.

Study participants. There were six participating financial institutions across three jurisdictions. From Ghana there were two banks, one savings and loan institution and one insurer. From Kenya, there was one bank that participated. From Mozambique there was one bank that participated. All assumptions made during the research were tested with the participating institutions.

3. Insights from inclusive compliance models

This section is divided into three sub-sections. The first two sub-sections consider risk assessment approaches and compliance activities to address the first research question: *What is the state of inclusive compliance models?* The third sub-section considers the second research question: *Which viable alternatives are possible to reduce costs while driving compliance and inclusion?*

3.1. Risk assessment

This sub-section considers firstly the principles that determine an effective risk assessment approach and assesses the current state of risk assessments used by financial institutions.

3.1.1. Principles to consider for effective risk assessment frameworks

In an institutional AML-CFT context, risk assessment involves the assessment of ML-TF risks as well as compliance and related risks with a view to achieving AML-CFT objectives. The box below elaborates on the definitions of key risks that play a role in an AML-CFT risk-based approach.

Box 1: Key financial sector risks

ML risk: The risk that a country, financial institution or business unit could be used for ML

TF risk: The risk that a country, financial institution or business unit could be used for TF. While in many respects this is like ML risk, TF risk has features that may be different.

Compliance risk: This is a risk that arises due to non-adherence with regulatory requirements. This can lead to fines and penalties for FSPs as well as reputational damage. Compliance risk is a major reason for de-risking[6] in the financial services sector.

Risk of financial exclusion: The risk of excluding customers due to lack of robust AML-CFT information can deprive people of financial services and lead to large unregulated informal sectors. This is a vulnerability that can be exploited for ML and illicit financial flows.

Illicit financial flows risk: Illicit financial flows are defined as the illegal cross-border movement of fund0s and resources. They have a significant impact on development outcomes by reducing tax revenue to governments (Cooper et al., 2018; Cenfri 2018; FATF, 2016).

6 According to FATF, de-risking is defined as "the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risk."

Furthermore, it is important to understand the distinction between *inherent risk* and *residual risk* when evaluating the appropriateness of the risk assessment frameworks and the allocation of resources in the risk-based approach:

- **Inherent risk** is the risk before mitigating controls.
- **Residual risk** is the risk after mitigating controls.

Risk-based approach to AML-CFT is compulsory[7]. The foundation for the design, development and implementation of an AML-CFT framework at country and institution levels is found in FATF Recommendation 1 (FATF, 2012). In this regard, the country level identification, assessment and understanding of the ML-TF risks should inform the actions taken to ensure the risks are mitigated effectively. The application of a risk-based approach will be underpinned by an AML-CFT regulatory regime that should enable country and institution measures that are proportionate. In other words, enhanced AML-CFT measures must be applied in respect of higher risks; and, where there are lower risks, simplified measures may be allowed under certain conditions.

Risk assessments core to AML-CFT risk-based approach. Risk assessments are key to understand risks and for the implementation of the risk-based approach. Without the application of a suitable risk assessment methodology, proportionate responses to the applicable AML-CFT obligations could be undermined. In other words, the mitigation measures that are applied by institutions may not, by design, be placed on higher risks, and the opportunity to provide simplified measures in respect of lower risks may not be appropriately structured. In broad terms, the allocation of resources could be misaligned, and the achievement of inclusive integrity objectives could be compromised.

International standards not prescriptive in the design of ML-TF risk assessments. International AML-CFT standards do not specify how ML-TF risk assessments must be undertaken by institutions. FATF guidance can be referenced to inform the approaches that are applied by countries and may be considered in the design of institution risk assessment frameworks. Further, the principles set out in various risk frameworks could be considered in framing the risk assessment methodologies of institutions. For example, ISO 31000 is referenced in the South African AML-CFT risk-based approach guidance. However, these standards should only be used in a manner that is appropriate for AML-CFT purposes where it suits the contextual factors.

Implementation of risk assessment frameworks required by national AML-CFT obligations. ML-TF risk assessment frameworks must comply with national AML-CFT obligations. While regulators do not usually specify the approach that must be followed, the framework must be positioned to meet the expectations of the AML-CFT authorities as well as any guidance that is provided. They should be designed with the following objectives:

- Compliance with AML-CFT obligations
- Achievement of required AML-CFT outcomes
- Proportionate compliance responses
- Alignment between financial integrity and financial inclusion imperatives

7 While the risk-based approach is compulsory, risks assessments are strongly encouraged for demonstrating the understanding of risks. However, without risk assessments it becomes increasingly difficult to identify, assess and address ML-TF risks.

Inclusive integrity outcomes an important consideration. The risk assessment framework should be designed to support the achievement of desired national inclusive integrity outcomes. This will be most effective where the country AML-CFT strategy and related policy is positioned to support such outcomes. To do so, risk assessment frameworks should:

- Be appropriate for the circumstances of an institution
- Effectively address relevant risks in a holistic manner
- Address each risk in context using a risk assessment methodology appropriate for each risk.

ML-TF risk factors for consideration in an institutional risk assessment framework. In a risk-based approach, institutions determine risk factors that will be used in assessing ML-TF risk. The following are considered in combination in the risk assessment process that is designed to facilitate proportionate compliance responses:

- **Product.** There are various ML-TF risks that can be inherent to a product offering. Some of the key aspects to consider are: Can the product be used by third parties unbeknownst to the provider, can the product be funded by cash, does the product facilitate the cross-border transfer of funds, or is there any historic evidence of such products used for ML-TF activities?
- **Delivery channel.** The delivery channel is the means through which the financial institution and the client interact with each other. Considerations such as whether the product is offered through intermediaries or whether the product is offered through non-face-to-face processes are relevant here.
- **Client.** Different types of clients typically require the inclusion of different attributes for risk-rating purposes. These attributes may be calibrated differently for categories of clients. It would be appropriate to use distinct approaches in respect of various types of individuals and types of entities. For example, politically exposed persons (PEPs) should be classified as high risk due to the nature of their profession.
- **Geography.** Different geographic locations have different exposures to ML-TF activities. Consequently, dealings with geographies with more ML-TF activities will result in an increase in the inherent ML-TF risk. Considerations here include whether the client is domiciled in the domestic country or abroad, whether the geographies where the client engages are identified as high-risk jurisdictions, and whether there are concerns about the effectiveness of the AML-CFT regime of the jurisdiction in which the client engages.

The features of each factor can be viewed in combination to assess the ML-TF risk[8].

Financial inclusion as an ML-TF risk mitigating factor. Products that facilitate financial inclusion could be viewed as mitigating risk at a sector or national level. Financial inclusion increases the visibility of transactions and other financial behaviour. This visibility enables supervisors to obtain a more holistic picture of the ML-TF risks at a national and sector level.

8 For a comprehensive list of ML-TF factors that should be considered, see FICA Guidance Note 7. https://www.fic.gov.za/Documents/171002_FIC%20Guidance%20Note%2007.pdf

Risk estimation methodology approaches. There are a number of approaches that could be considered when developing processes that estimate ML-TF risk. The approach that is used should be effective in achieving the required AML-CFT outcomes. It is also important that institutions implement risk assessment methodologies that are sustainable and do not need to be continually overhauled. Here are two examples:

- **Risk-rating methodologies.** This type of risk assessment methodology considers the *impact* of a risk and the *likelihood* of it occurring. This may be determined through the product of the *impact* and *likelihood* variables, using a relevant rating scale, and assessing the risk in relation to an appropriately calibrated classification scale.
- **Risk-scoring methodologies.** This type of risk assessment methodology uses a scoring approach in the classification of risks that relies on the sum of the risk scores that are allocated in relation to ML-TF factors that are considered. The calibration of the factors should be determined by the relative importance of each. For example, a relatively low impact factor could be assessed using a three-point scale, and a relatively high-impact factor could be rated using a 10-point scale. The sum of the respective scores would then be used to determine the risk classification.

Further mitigation measures necessary to deal with residual risk. Residual ML-TF risk should be determined after considering risk mitigation measures. For example, the functionality of a product could be limited from a transaction value or volume perspective. This can be done by limiting the number of transactions or the cumulative value that is allowed, which would serve to mitigate product risk. The risk score that is provided would be adjusted to reflect such risk mitigation.

Risk classification according to complexity of offering. It is suggested that a five-level risk classification scale be applied by an institution that has a diverse product and delivery channel offering, provided that this results in substantially different compliance responses for each risk classification level. Where this is not the case, the levels in question should be rationalised[9]. Table 1: Risk classification scale provides an illustration of a risk classification scale:

No.	Risk classification	Compliance response	Risk context
1	Low risk	Low-risk measures	Proven low risk
2	Lower risk	Simplified measures	Cost-effective measures
3	Moderate risk	Standard measures	Cost-effective measures
4	Higher risk	Enhanced measures	Ongoing focus
5	Very high risk	Exceeds risk appetite	Business exit

Table 1: Risk classification scale

9 The table is intended as an example only and institutions should make use of a scale that is appropriate to its circumstances. For example, where an institution has a single lower-risk product that is delivered to a uniform lower-risk population, a five-point scale could be rationalised to reflect a smaller number of risk classifications, i.e. to address the simplified, standard or enhanced measures that may be appropriate.

Emphasis should be AML-CFT outcomes rather than inputs to ensure inclusive integrity. Undertaking an ML-TF risk assessment is not in itself the turning point towards AML-CFT measures when adopting a risk-based approach. The challenge lies in the adoption of processes and systems that are dynamic and appropriate in the country and institutional AML-CFT context. This entails moving away from approaches where the majority of institutions' AML-CFT efforts are placed on inputs of the ML-TF risk management process, for example documenting and recording the identification and verification of customers or the periodic review of documentation or records. There should be increased emphasis on the outputs of ML-TF risk management processes that place an ongoing focus on AML-CFT outcomes. The effective use of resources plays an important role in this regard. Particularly in a manner that draws resources away from lower-risk exposures and places attention on higher-risk exposures. Digital AML-CFT systems enable financial institutions to allocate resources more effectively to higher-risk exposures.

Resource allocation should correspond with risk assessment outcomes. Considering international standards, the application of a risk-based approach will mean that AML-CFT resource allocation should be appropriately focused on higher ML-TF risks. Relatively more resources should be spent on mitigating the risk of doing business with higher-risk clients, and relatively fewer resources should be spent on mitigating the risk of doing business with low-risk clients. Therefore, resources should be drawn away from lower-risk exposures. If this is not done, costs across a client base may be inappropriately skewed towards lower-risk exposures.

3.1.2. Current state of risk assessment frameworks

Against the above risk issues and principles, this section shares findings on the current state of risk frameworks in the study countries.

Allocation of resources not part of country-level AML-CFT policies. A national AML-CFT policy serves to guide and support AML-CFT stakeholders in the achievement of desirable ML-TF risk mitigation outcomes. It is therefore important that consideration of the allocation of resources in relation to ML-TF risk form part of the AML-CFT formulation to ensure appropriate cost of compliance. Country stakeholders indicated that they were not aware of country-level AML-CFT policies that have been formulated by considering an understanding of the cost-effectiveness of measures that are applied by institutions.

Country AML-CFT obligations structured through a rules-based approach. In all countries that formed part of the study, the AML-CFT obligations were largely framed in a rules format. Although a risk-based approach is compulsory, the FATF Recommendations do not specify how the risk-based approach should be framed in laws, regulations, directives or guidance. A rules-based approach would typically be drafted in a manner that provides for specific AML-CFT measures that must be adopted. This may afford a relatively high level of certainty relating to what must be done by stakeholders but is often inflexible and may not keep pace with changing circumstances.

Rules-based approach requiring proof of address without consideration of risk mitigation. AML-CFT-related regulation required participating institutions to collect proof of address as part of due diligence processes. However, proof of address offers limited ML-TF risk mitigation ability, given constraints such as undeveloped address systems. Proof of address is a paper document that is vulnerable to manipulation, as it can be copied or edited and is therefore susceptible to fraud. Further, in many developing market contexts, there is no central repository that exists where proof of address documents can be easily and reliably verified, which makes it further susceptible to fraud. The impact of removing proof of address was therefore considered as one of the scenarios later in the study.

Development of robust risk assessment frameworks nascent. The effectiveness and maturity of risk assessment processes varies between institutions. Institutions apply various risk assessment methodologies and are still in the early stages of a journey towards implementing approaches that will be effective in achieving AML-CFT objectives. Financial institutions typically use a macro-approach to assessing ML-TF risk. In other words, clients are grouped according to a number of characteristics, and the risk is assessed accordingly. Ideally, each client should be profiled and their individual risk assessed.

Risk assessment outcomes indicative of underlying methodological concerns. Most clients of participating institutions have been rated as low or lower risk, sometimes up to 99% of clients. The risk profile of clients, as assessed by institutions, is therefore heavily skewed towards the lower-risk classifications. This is the client base subject to simplified due diligence measures. Supervisory authorities may express concern about institution risk assessments where the proportion of medium and higher-risk clients is very low in relation to the total client base, as it is highly doubtful that such a small percentage of retail clients warrants no additional due diligence measures.

Misperceptions at risk of undermining risk-based approaches. We identified five common fallacies that drive supervisory and institutional behaviour with regard to risk assessment frameworks. These perceptions are leading to inefficient and ineffective risk-based approaches.

- **Fallacy 1: Different risks do not require separate definitions.** The risk assessment methodologies used by financial institutions address all risks in a combined manner. For example, ML risk assessment is not necessarily separately undertaken from the TF risk assessment. Further, compliance risk is typically not defined in a manner that differentiates compliance risk assessment outcomes in relation to ML-TF risks. While there is a broad overlap between the respective risks, risk assessment processes should be structured in a manner that recognises the institutional compliance context. Clear risk definitions play an important role in the development of risk assessment frameworks. These should address ML, TF, compliance and related risks in an integrated manner while recognising the inter-related but different aspects of each risk. This will avoid circumstances where the risk implications are inappropriately conflated.
- **Fallacy 2: Higher compliance spend means better compliance.** There are strong beliefs that time-consuming and costly AML-CFT measures must be maintained regardless of changing circumstances. In other words, greater resource allocation is seen as more effective than the use of fewer resources. This is particularly the case in relation to legacy due diligence measures that involve manual processes and obtaining copies of documents used. Supervisors recognise that proportionate responses to AML-CFT obligations are desirable. However, the graduated compliance responses are typically specified in a rules format which is driven by legacy-based perceptions.
- **Fallacy 3: Client risk ratings should show a normal distribution across risk categories.** Some supervisors indicated that they believed there should be a normal distribution of clients across risk categories. In other words, the risk assessment process applied by financial institutions should result in a bell curve across the risk categories[10]. This is not the case, since the risk assessment is conducted against a set of normative principles. For example, the entire population of clients could have features that indicate lower-risk ratings are appropriate as a direct result of the attributes of the population, due to their inherent risk profile.
- **Fallacy 4: Proof-of-address measures are required to effectively mitigate ML-TF risk.** Both supervisors and financial institutions articulated the importance of proof-of-address measures to mitigate ML-TF risk. However, when probed, there was uncertainty about the

10 The expectation is that some clients will be classified as low risk, some as high risk, but the majority as medium risk.

value of proof of address as an identifier. From discussion, it became apparent that proof of address was mostly used to mitigate compliance risk.

- **Fallacy 5: Manual processes are as good as digital systems for AML-CFT outcomes.** Currently, almost all AML-CFT measures used by financial institutions rely on manual processes. The value that AML-CFT systems offer is often underestimated by both financial institutions and supervisory authorities. Where there is a large number of clients and transactions, systems are needed to efficiently and effectively assess risk and support the AML-CFT measures.

Institutional compliance with AML-CFT focused on inputs rather than outcomes. One of the AML-CFT behaviour drivers in institutions is the fear that fines, penalties or sanctions will be imposed for non-compliance. While this is not necessarily inappropriate where there is non-compliance, the achievement of inclusive integrity outcomes would be better served where the core behaviour drivers are directly related to the mitigation of ML-TF risks. Although the respective programmes of institutions address the need to mitigate such risks, the indications are that the risk that is most relevant to institutions is compliance risk. That is, ensuring that all the requirements in regulations are adhered to rather than ensuring effective ML-TF risk mitigation.

3.2. Compliance activities and their cost

This sub-section contains a write-up of key features of the AML-CFT costs. To understand the state of inclusive compliance approaches, the main compliance activities and their associated cost were considered. A base-case model for the typical financial institutions was developed as the basis for the analysis.

Results from the application of the inclusive compliance models methodology. Table 2 contains ranges of the costing information gathered from institutions during the workshops[11]. This information was used to construct the base-case scenario discussed below. Refer to Section 2 for more information regarding the information collection process.

Organisation profile	Maximum No.	Minimum No.
Total clients	1.1m	0.1m
Total staff	1.1k	0.2k
Full-time equivalent (FTE) staff to undertake	81	6
Cost of compliance – Total	Maximum (USD)	Minimum (USD)
Total	1,664,948	92,118
Cost of compliance – AML-CFT activities	Maximum (USD)	Minimum (USD)
Compliance Framework	17,227	1,019
Governance of Compliance	45,192	4,297
AML-CFT Assurance	20,457	1,854
AML-CFT Systems	201,110	3,751
Onboarding Due Diligence	432,749	19,524
Ongoing Due Diligence	891,515	28,632

11 Ranges were used to ensure the anonymity of the institution.

Organisation profile	Maximum No.	Minimum No.
Transactions Monitoring	142,101	949
Reporting	3,877	386
Record-keeping	35,257	2,985
Training	51,395	10,140
Relationship with Regulators/ Supervisors	3,947	511

Table 2: Ranges indicative of the variety of institutions that participated in the study

The size and complexity of the type of financial institution disproportionally affect cost of compliance. Unsurprisingly, the results from the costing exercise indicates that, as the number of clients and the size of the financial institution increase, so does the cost of complying with AML-CFT regulation. However, it is not a linear relationship. Some of the banks that participated in the study spent around USD16.3 on AML-CFT activities per client per annum. In contrast, some of the non-bank institutions spent less than USD0.6 on AML-CFT activities per client per annum. Similarly, cost of compliance per staff member also varies greatly according to the complexity of the AML-CFT processes as well as the inherent risk of the products sold by the financial institution.

Cost ratios of participating institutions	Maximum USD	Minimum USD
Cost of AML-CFT compliance per client	16.3	0.6
Cost of AML-CFT compliance per staff member	1,088	146

Table 3: Cost ratios of participating institutions

3.2.1. Base-case model[12]

Input obtained through individual interactions with project participants and completion of institution costing models has been used to develop a generic base-case model, the details of which are contained in Annexure 4: Cost-of-compliance base case model. The scenario is used to illustrate the cost of compliance for a typical one-year cost cycle of a hypothetical organisation. In other words, it facilitates the costing of identifiable AML-CFT activities to produce an annual cost picture. The model has been developed with a bank cost-of-compliance context in mind. However, in view of the similar AML-CFT cost themes across all institution types, it can be used to broadly illustrate costing dynamics in various contexts.

Base-case model methodology. The project costing model that has been used to analyse the cost profile of AML-CFT measures of participating institutions has been adapted to produce a picture of the costs relating to AML-CFT activities as described in Section 2.

12 The project team constructed a base-case model to protect the anonymity of the institutions that participated and to protect their competitive advantages.

Assumptions. The project team made the following assumptions in the construction of the base-case model. The assumptions were based on common features exhibited by the financial institutions that participated in the study[13].

- **Commercial bank.** Offers a suite of corporate, commercial and retail products. The cost of compliance is an important consideration in view of plans to target growth in entry level business.
- **Staff total.** 350 staff members (includes eight board members)
- **Client base.** 250k clients with an annual growth rate of 12%[14]. Most of the clients have been assessed as lower risk.
- **Operating expenses**. Staff costs amount to 55% of total operating costs. Total operating expenses are equal to USD9,928,571.[15]
- **Overheads.** The overhead allocation is 10% as a proportion of staff costs.
- **Depreciation rate.** The systems depreciation period is assumed at four years. Therefore, a depreciation rate of 25%.
- **AML-CFT systems**. A client-screening system has been implemented and the development of an end-to-end AML-CFT system is being considered but has not yet been developed or acquired.
- **CDD processes are largely manual.** Onboarding and ongoing due diligence processes are largely manual and paper-based, in a manner that meets the expectations of the AML-CFT authorities.
- **Proof of address required as part of rule-based approach.** AML-CFT due diligence measures include proof-of-address processes for retail clients, which are specified in regulatory obligations in a rules format.
- **Transactions monitoring.** The organisation has transactions monitoring capacity that relies on staff member review of transactions that are unusual or suspicious.
- **Record-keeping is paper based.** AML-CFT record-keeping is largely paper-based and records are stored in physical storage facilities.
- **Other compliance programme items.** The bank has, and maintains, an AML-CFT programme that addresses the compliance framework, governance of compliance, AML-CFT assurance, reporting, training, and relationship with supervisors.

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13 The construction of the base case model was an iterative process. The first iteration was based on typical features and figures observed at the financial institutions that participated in the study. The first iteration was then tested with a number of industry experts and refined according to their input.

14 All the financial institutions that participated in the study had relatively high growth rates, similar to 12%. This is mainly as a result of significant retail opportunities that exist in the contexts in which the financial institutions operate as well as the relatively low base.

15 This number was derived by calculating the total staff costs in the base case model and then adding the non-staff cost component of operation costs. Staff costs was calculated by using staff remuneration rates per staff level, in line with that of the study participants, and multiplying it by the number of staff members at each level. The assumption that 55% of total operating consist of staff costs is based on information from the workshops conducted with the financial institutions. Therefore, a further 45% was added to staff costs to estimate total operating costs. For more information see *Annexure 4: Cost-of-compliance base case model.*

Table 4 contains the organisational profile of the base-case scenario:

Organisation profile	
Total clients	250,000
Total staff	350
Full-time equivalent (FTE) staff to undertake	25
Cost of compliance	***USD***
Total	403,740
Implementation costs	0
Staff costs	312,232
Overheads	31,223
Equipment (including depreciation)	31,500
Materials	28,785
External services	0
Cost-of-compliance ratios	***USD***
Cost of AML-CFT compliance per client	1.61
Cost of AML-CFT compliance per staff member	1,154

Table 4: Base-case scenario organisation profile

Legacy approach to AML-CFT resulting in low implementation costs and use of external services. Where an AML-CFT regime has been in place for an extended period, the financial institution will not incur costs to implement new AML-CFT measures, nor will it require external services to revise its AML-CFT measures in line with new obligations. The regulatory context in which the base-case scenario originated has been stagnant and reliant on a legacy rules-approach to AML-CFT. Therefore, there is no need to implement new systems, processes or skills on an annual basis to ensure ongoing compliance with the AML-CFT regime.

Staff costs accounting for the majority of compliance costs incurred. Staff cost is a function of time and remuneration rates. The most significant staff related costs have been identified in relation to onboarding and ongoing due diligence. This cost is driven by processes that are applied in face-to-face interactions with clients when they are onboarded and in ongoing processes that comply with the applicable AML-CFT due diligence obligations. The need to obtain copies of documents from clients and periodically update these over the course of business relationships is a significant driver of due diligence costs.

Low equipment cost arises from little investment in AML-CFT systems. The use of AML-CFT systems is still limited. Financial institutions conduct most AML-CFT processes manually, which increases inefficiencies driving up the cost of compliance. The upfront capital required to purchase AML-CFT systems acts as a deterrent for smaller financial institutions that do not yet benefit from significant economies of scale. There is, however, scope to improve the effectiveness of AML-CFT measures by investment in appropriate systems.

Relatively low material cost. To be conducted effectively, many of the AML-CFT activities as well as the training of staff members require material, such as stationery. However, in the greater scheme of compliance costs, the costs incurred to acquire materials is low.

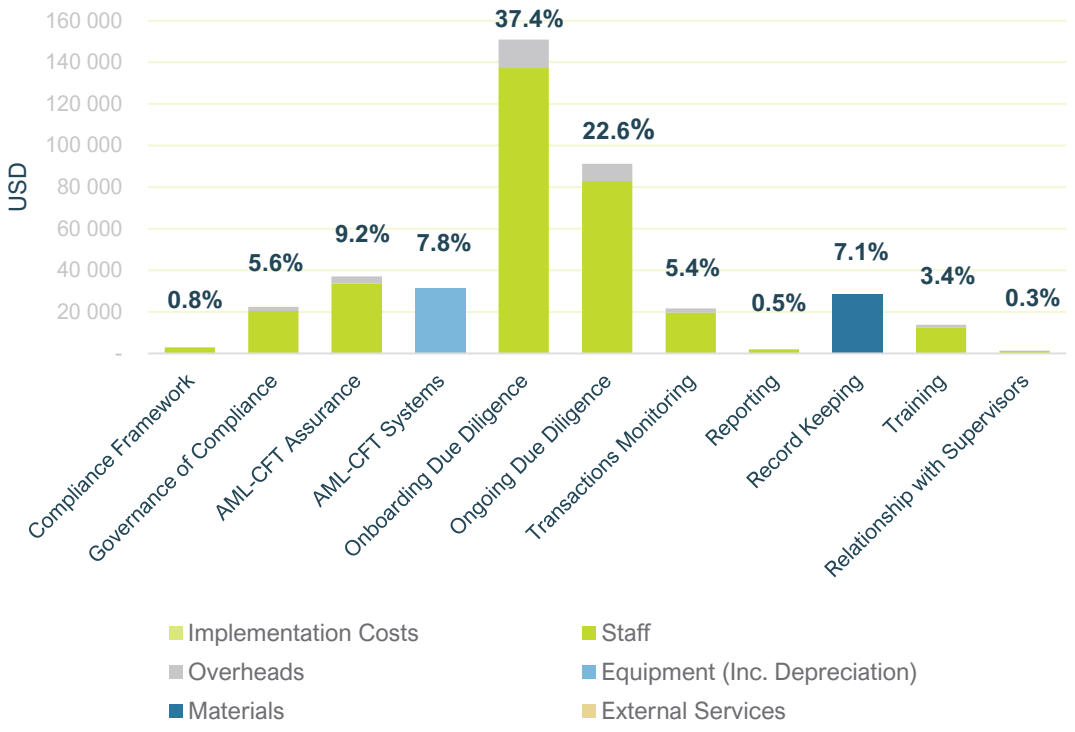

Figure 2: Cost-of-compliance activities – Base-case (annual)

Source: Project base-case scenario

The rules-based approach skews costs towards due diligence activities. A rules-based approach formulates the requirements for due diligence processes that financial institutions must adhere to. The cost implication of this can be seen in the costing of compliance results of the base scenario. Most resources (60%) are allocated to due diligence activities to ensure compliance with rules and thereby minimising compliance risk. Significantly fewer resources are allocated to transaction monitoring (5.4%), which is the primary tool to determine ML-TF risk on an ongoing basis.

Record-keeping cost substantial due to the prevalence of manual, paper-based processes. Supervisory frameworks require financial institutions to keep paper records of client identification and other due diligence documentation for a minimum period of five years. Consequently, institutions have to allocate a considerable number of resources (7.1% of total compliance costs) to the storage and safekeeping of this documentation.

Cost of governance of compliance and AML-CFT assurance activities driven by seniority of staff members involved. As shown in Figure 3, almost all the costs relating to the governance of compliance and AML-CFT assurance are staff costs. Senior management and board members are responsible for the governance of compliance activities at a financial institution. The high hourly remuneration rates of these staff members result in approximately 6% of total compliance resources allocated to the governance of compliance activity. Similarly, activities relating to AML-CFT assurance involve the internal audit team and senior operations staff, which is more costly than frontline staff.

Compliance costs a significant proportion of total operating costs. The total operating costs for the base-case scenario is estimated at USD9,928,571, as explained in the assumptions section. This entails all the expenses incurred to operate, maintain and administer business activities daily, including staff costs. The costs incurred to comply with AML-CFT regulation forms part of operating costs. Total cost of AML-CFT compliance costs, calculated at USD403,740, accounts therefore for 4.1% of total operating costs.

3.3. AML-CFT compliance scenario analysis

This section considers potential viable alternatives to current AML-CFT activities to reduce costs while still driving compliance and inclusion. Two scenarios were analysed:

- Firstly, a transition to a principles approach to AML-CFT obligations and the subsequent removal of proof of address as a requirement for CDD processes
- Secondly, a transition away from manual processes for AML-CFT activities to a more automated AML-CFT compliance environment

The base case model was used to consider the impact of changes in approach. The scenario results assume that all other factors remain constant as specified in the base-case model.

3.3.1. Principles-based obligations and removal of proof of address

Rationale. Where AML-CFT measures are determined in a rules-oriented regulatory regime, they are fixed in nature and often apply uniformly to all institutions. As described in Section 3.2, country AML-CFT obligations are, for the most part, set out in a rules format. This means that the cost of compliance is dependent on the rules. There is often limited opportunity to apply innovative but effective approaches that will achieve AML-CFT objectives – approaches that will offer lower-cost due diligence measures and potentially increase the effectiveness thereof.

Supervisory authorities demand proof of address as part of the rules-based obligations. The expectation of the AML-CFT authorities is that institutions must obtain and verify the residential address of customers. Accordingly, this expectation establishes the due diligence baseline. In other words, institutions do not have the option to use alternative appropriate and effective measures that may be less costly, thereby resulting in a favourable outcome for inclusive integrity.

Proof of address is a relatively costly identifier. Costs relating to proof-of-address measures are significant. Notably, discussions held during workshops revealed that proof-of-address-related due diligence measures could constitute some 60% of the total due diligence cost of compliance. Accordingly, where this requirement is removed, without diluting the effectiveness of due diligence measures, due-diligence-related costs can be more than halved without adversely affecting the effectiveness of the due diligence measures. Furthermore, the proof-of-address requirement may result in multiple CDD engagements with prospective clients. Clients often neglect to bring along their proof of address the first time the account opening process is initiated, or the quality of their proof of address is insufficient. Unsuccessful or repeated CDD engagements increase costs further for financial institutions.

Proof-of-address verification measures are ineffective. The ability to verify the address of a prospective client based on their proof-of-address document is limited. In most African countries there is no centralised address repository against which the proof of address can be verified.

This makes proof-of-address documentation highly susceptible to fraud. Therefore, address verification processes are not an effective ML-TF risk mitigation measure. For the most part, financial institutions request proof of address from clients to mitigate compliance risk, and not to mitigate ML-TF risks.

Scenario features. The features of the scenario of removing proof of address are:

- The scenario builds on the institutional parameters as discussed in the base-case scenario.
- AML-CFT due diligence obligations are changed to allow for innovative cost-effective measures.
- The new measures can be implemented in a manner that will save 60% of the time needed by staff members in undertaking the onboarding and ongoing due diligence processes in respect of retail and digital business.
- Record-keeping costs relating to AML-CFT activities are halved due to proof-of-address documentation not being stored anymore.

Scenario results. Moving away from a rules-based approach and allowing financial institutions to be more innovating in their adherence to national AML-CFT obligation will result in a 39% decrease in overall cost of compliance. The removal of proof of address as a requirement in the due diligence process will reduce costs of CDD processes by 60%. It will also halve the record-keeping costs that can be attributed to compliance with AML-CFT regulation. This is reflected in Figure 3.

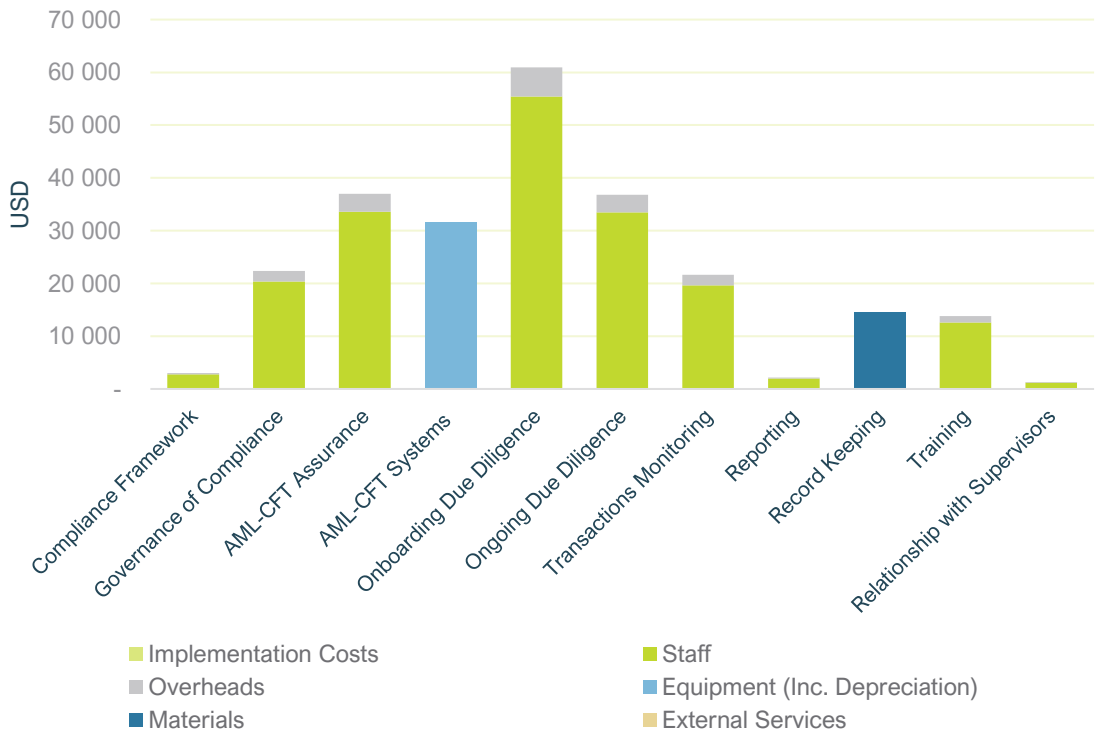

Figure 3: Cost-of-compliance activities – Proof-of-address saving

Material reduction in bottom-line impact of cost of compliance. The scenario results of 39% savings in the cost of compliance reduces the total cost of compliance amount to USD244,919. Therefore, the proportion of operating costs attributable to the cost of complying with AML-CFT obligations reduces from 4.1% to 2.5%.

3.3.2. Automated processes under a rules-based approach to AML-CFT obligations

Rationale. A large proportion of an institution's cost of compliance is incurred by frontline staff members. They undertake due diligence measures at the client onboarding stage and over the course of business relationships. The costs relating to these measures are driven by the time taken by frontline staff to obtain and process client identity documentation and relevant information. Therefore, the cost of compliance is strongly affected by the extent of manual and paper-based processes.

Automated digital processes an opportunity for cost saving, but dependent on regulatory approach. Cost of compliance can be significantly reduced where client identification and verification measures rely on digital enabled due diligence measures. This can be achieved through new technologies. However, new technologies may involve significant systems development or acquisition costs. The ability of financial institutions to offset the capital costs involved to acquire a new system with the savings from a reduction in manual AML-CFT processes will depend on the regulatory regime. If the regulatory regime requires manual processes through a rules-based approach to AML-CFT activities, then financial institutions will not be able to benefit from the cost savings of automated digital processes. In contrast, if the regulatory regime allows for an innovative approach to institutional AML-CFT activities, then there will be increasing scope for cost saving.

Scenario features of automated process in a rules-based approach to AML-CFT activities. The scenario features are:

- The scenario builds on the institutional parameters as discussed in the base-case scenario.
- The development and implementation of a sophisticated system to automate AML-CFT processes will cost USD400,000[16].
- There is a rules-based approach in place to AML-CFT obligations. The lack of a flexible regulatory regime limits the savings opportunities from potential efficiency gains of the new system.

Scenario results in a rules-based approach to AML-CFT activities. The additional system increases the annual cost of compliance by USD100,000[17]. Since the AML-CFT regulatory regime is based on a rules-based approach, there is limited scope for efficiency gains as a result of the new system. Therefore, the cost of the other AML-CFT activities remains the same as for the base-case scenario. The new cost profile is depicted in Figure 44.

16 The assumption on the cost of the AML-CFT system implemented by the scenario institution is based on expert interviews and sense checked with participating institutions.

17 Depreciation rate of 25% per annum

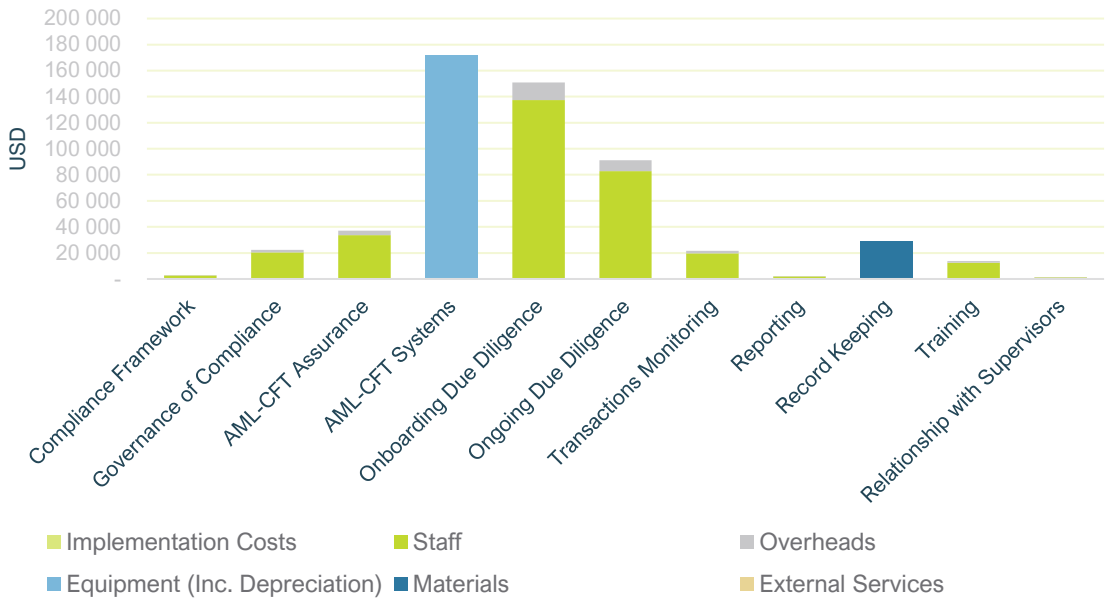

Figure 4: Cost-of-compliance activities – automated processes in an inflexible regulatory environment

Source: Project scenario

Automated processes lead to significant cost-of-compliance increases in an inflexible AM-CFT regime. The additional AML-CFT systems cost has a material impact on the bottom-line of the financial institution. The acquisition of the additional system results in cost of compliance with AML-CFT regulation increasing to USD543,740 (24.7% higher). The share of AML-CFT compliance in operating costs increases from 4.1% to 5.4%.

3.3.3. Automated processes under a principles approach to AML-CFT obligations

A flexible approach to AML-CFT will allow for scope cost savings and enhanced effectiveness. There is significant potential for cost savings where manual AML-CFT processes are allowed to be automated. At the same time, automation through digital systems will enhance ML-TF risk mitigation outcomes. Notably, automated processes can provide assurance of identity and support the collection of information that is needed for risk assessment purposes and compliance responses. This can be done in a manner that does not resort to legacy paper-based measures and will result in timesaving by frontline staff that undertake onboarding and ongoing due diligence activities. There will also be some saving in respect of record-keeping materials and the storage thereof. However, more time will be required for AML-CFT monitoring purposes.

Scenario features in a flexible approach to AML-CFT activities. The updated scenario features are:

- A principles regulatory approach is taken to the risk-based approach.
- Significant cost savings can be realised through automation.
- Frontline staff spend 60% less on onboarding and ongoing due diligence processes due to the efficiency gains of digital automation[18].

18 The 60% is based on extensive consultation with the financial institutions that participated in the study.

- Record-keeping cost-saving amounts to 50% due to increased efficiencies[19].
- Transaction-monitoring-associated costs increase by 100% due to more emphasis placed on understanding transaction profiles of clients and detecting ML-TF risks on a continual basis through transaction monitoring.
- All other base-case assumptions remain unchanged.

Scenario results in a principles approach to AML-CFT activities. The cost associated with AML-CFT activities decreases from USD543,740 to USD407,815. In the more flexible approach to AML-CFT, the financial institution can benefit from the efficiency gains of using a more comprehensive AML-CFT system. The result is a reduction in time spent on CDD activities and lower material costs associated with record-keeping because of lower emphasis on the importance of obtaining documentation. In contrast, there is an increase in the time spent on transaction monitoring and reporting to the supervisor, as understanding the financial profile of the client becomes more important in the financial institution's ML-TF risk mitigation strategy.

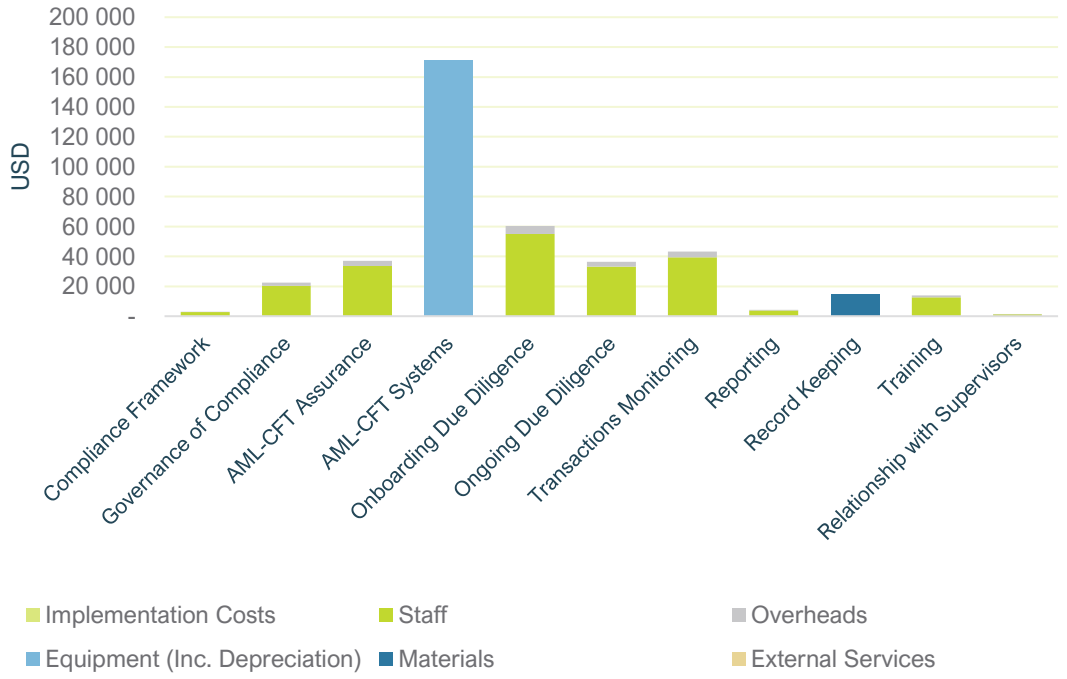

Figure 5: Cost-of-compliance activities – automated processes in a flexible regulatory environment

Source: Project scenario

Efficiency gains of automated processes leaves more scope to serve lower-income consumers. With the acquisition of the new AML-CFT system in a regulatory environment, which allows for the efficiency gains to materialise, cost of compliance as a proportion of operation costs decreases from 5.4% to 4.1%. This is a similar proportion as during the base-case scenario. However, there are a number of key differences in ML-TF risk mitigation outcomes. Firstly, the emphasis has shifted from identifying clients with a high degree of certainty to understanding who they are. Secondly, fewer resources are spent on low ML-TF risk clients, due to a reduction in time spent on CDD processes. More time is now spent on understanding and monitoring higher-risk clients. This increases the value proposition of serving lower-income consumers and national financial inclusion objectives.

19 The 50% is based on extensive consultation with the financial institutions that participated in the study.

4. Conclusion

This document distils insights from a detailed cost-of-compliance modelling exercise conducted with six financial institutions in Africa, making it the first study to document actual costs of AML-CFT compliance across different cost drivers in Africa. In so doing, it puts into stark relief the implications of the largely still rules-based AML-CFT regulations and compliance practices on the continent, where the emphasis is on the inputs (in terms of documentation and compliance procedures) required to manage risk, rather than the risk outcomes to be achieved.

Moving towards a risk-based approach that will achieve the objective of inclusive financial integrity requires the development of more inclusive compliance models based on a deeper understanding of risk as well as cost drivers, and with more flexibility to apply resources towards the management of risk in the most cost-effective way.

While (in principle) there may be buy-in to move towards such an approach, there is still much ground to be covered in developing the processes, systems and people controls needed to implement an effective risk-based approach. Indications are that institutions are still on a learning curve. Thus, there will be value in providing technical support that leverages sound risk principles to the advantage of AML-CFT outcomes, and in building industry-level support for the development of an approach that is suitable for local circumstances. This will reduce the learning curve and enhance the effectiveness of the AML-CFT regime.

5. Recommendations

This section builds on the learnings from Section 3 to articulate key recommendations for national AML-CFT authorities and financial institutions.

5.1. Financial institutions and national AML-CFT authorities

Enhance understanding of cost and risk. In the first instance, national authorities and financial institutions alike require a better understanding of compliance cost and ML-TF risk. This entails that costs be quantified to enable effective risk mitigation and efficient resource allocation. Traditionally, most of the emphasis in the ML-TF risk mitigation discussion has been on understanding the benefits of compliance practices. Little research and understanding exist on the cost side of AML-CFT compliance and how that relates to risk. Building such an understanding holds advantages for financial institutions and regulatory authorities alike:

- For **financial institutions**, a deeper understanding of the cost of compliance of AML-CFT activities will help to determine AML-CFT investment decisions that align with risk factors, which will in turn result in a compliance and business advantage for the financial institution. If no quantitative analysis is done on the resources spent on AML-CFT activities, institutions will struggle to understand the appropriateness and efficiency of their ML-TF risk mitigation strategies, which will disproportionally affect low-income consumers.
- For **national AML-CFT authorities**, deeper insight into cost and risk drivers will make it possible to determine the potential impact of AML-CFT obligations before they are brought into effect. It will also facilitate the development of risk-based AML-CFT regulatory and supervisory approaches that will support the achievement of desired AML-CFT outcomes. This can, in turn, improve the effectiveness of compliance measures by financial institutions, thereby reducing costs.

Apart from this cross-cutting imperative, we also identify specific recommendations for national AML-CFT authorities and financial institutions, respectively, as outlined below.

5.2. National AML-CFT authorities

Focus on the outputs of AML-CFT measures to achieve outcomes. There should be ongoing consideration of what is needed to encourage an appropriate focus on the outputs of AML-CFT measures. Here the scenarios on the removal of proof of address and digitisation are most informative. By measuring inputs (documents) and not outputs (lower residual risk) supervisors require financial institutions to engage in costly AML-CFT activities that have limited risk mitigation benefits. Supervisors should not encourage financial institutions to employ costly AML-CFT measures but rather effective AML-CFT measures. Such a change will enable financial institutions to drop documentation requirements with limited risk mitigation value, such as proof of address, and encourage digitisation to enhance the efficiency and effectiveness of AML-CFT activities.

Align risk-based approach and AML-CFT policy to financial inclusion and development objectives. In order for financial institutions to find the correct balance in their resource allocation to ML-TF risk identification and mitigation processes, it is important that national AML-CFT

strategies incorporate inclusive integrity objectives. Without deliberately articulating inclusive integrity objectives and establishing an accountability framework for them, there will be limited incentive from an AML-CFT perspective for financial institutions to promote inclusive integrity. Further, the cost of compliance with AML-CFT obligations should be considered in strategy and policy formulation and implementation thereof. AML-CFT policy should specifically address resource allocation, i.e. the focus being on higher-risk exposures, and should be developed on the strength of measurable outcomes. This will be supported through appropriate costing models to facilitate an understanding of costs at country and institutional levels.

Frame AML-CFT obligations to encourage cost-effective measures. Consideration should be given to the manner in which AML-CFT obligations are framed and the impact that this has on the cost of compliance. Where a strict rules-based approach is applied, this will create certainty related to compliance obligations, i.e. the AML-CFT authorities and institutions will know what is required to avoid fines, penalties and sanctions for non-compliance. However, the rules may have unintended outcomes and will be a significant determinant of the cost of compliance and could result in the allocation of resources that is not optimal for risk mitigation purposes. Country AML-CFT obligations should allow for cost-effective measures by institutions. Proportionality and flexibility are required to allow for the achievement of policy outcomes rather than a narrower implementation of the rules.

Factor cost of compliance or into regulatory impact assessments. The costs that financial institutions incur to comply with changes in AML-CFT regulations should be considered when conducting regulatory impact assessments. As articulated in this study, cost of compliance has a direct impact on other policy objectives such as financial inclusion. Therefore, considering cost-of-compliance factors when conducting regulatory impact assessments will provide a more accurate picture of the change in regulation. This will ultimately enhance overall inclusive integrity outcomes and the implementation of the risk-based approach.

5.3. Financial institutions

Understand and mitigate each type of risk separately. Institutions should describe ML-TF and related risks in their AML-CFT programmes. Subsequently, risk assessment models should be structured to address ML, TF, compliance and related risks to facilitate the proportionate allocation of resources. Financial institutions should address risk mitigation within the context of each of the risks in question. Compliance, ML and TF risks are all different in nature, but are closely related. The question of what risk is being mitigated when applying AML-CFT measures should be considered as well as the cost-of-compliance implications and the need for effectiveness of measures that are implemented.

Move to dynamic risk assessment and mitigation. There should be an appropriate focus on the allocation of resources in the development of internal AML-CFT rules. Currently, the static nature of the internal rules of financial institutions means that risk mitigation resources are not dynamically employed to respond to ML-TF risks. This is to some extent a result of the rules-based national AML-CFT environments in which financial institutions operate as well as their lack of AML-CFT systems and transaction monitoring. Financial institutions should invest more in AML-CFT systems that enable them to understand the transaction patterns of clients and thereby make them more effective at detecting ML-TF risks on an ongoing basis. However, this transition away from static CDD processes to more dynamic processes will only be possible after AML-CFT obligations become more principles based and less rules orientated.

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Annexure 1: Overview of costing model

The costing model is structured in a number of MS Excel workbook sheets. The functionality of each sheet is outlined below.

Sheet number	Sheet name	Functionality
Sheet 1	Cost of Compliance Calculator	This sheet is used to capture information relating to an institution and matters that relate to AML-CFT compliance. It is used to calculate costs relating to AML-CFT compliance.
Sheet 2	CDD Process Analysis	This sheet is used to calculate the time taken and cost to onboard clients and undertake ongoing due diligence processes across different risk ratings. The outcome of the calculations is used in determining the cost of compliance.
Sheet 3	Total CDD Process Cost	This sheet automatically calculates the total cost to review the due diligence of a client base over an institution's review period – based on inputs provided in Sheets 1 and 2.
Sheet 4	Income Statement	This sheet integrates the cost implications from the respective sheets and reflects these under appropriate headings. It is designed to indicate the overall annual cost of compliance in respect of a scenario being modelled.
Sheet 5	Cost of Equipment Summary	This sheet reflects the cost of equipment or assets acquired for AML-CFT purposes.

Sheet 1 – Cost of Compliance Calculator – includes a section that is used to capture inputs to calculate the cost of compliance and produce cost-of-compliance outputs in other sheets.
The key inputs are:

- Legal registered name of company
- Total number of clients
- Client base growth/onboarding rate per annum
- Client base offboarding rate per annum
- Risk-rating distribution
- Currency code
- Number of staff and currency value of one hour of time
- Number of hours in one working day
- Overheads costs (% allocation)
- Systems depreciation period
- Systems annual maintenance % of cost

The cost of AML-CFT compliance is estimated considering the following cost activities:

- Compliance framework
- Governance of compliance
- AML-CFT assurance
- AML-CFT systems
- Onboarding due diligence
- Onboarding AML-CFT risk process
- Ongoing due diligence
- Ongoing AML-CFT risk process
- Transactions monitoring
- Reporting
- Record-keeping
- Training
- Relationship with supervisors

These items were identified by the study facilitators based on their knowledge and experience of the measures that are applied by institutions in the application of a risk-based approach.

Annexure 2: AML-CFT activities

Cost-of-compliance-related activities have been identified in respect of AML-CFT obligations that are imposed and implemented by institutions. These can be structured under the headings included in the left-hand column of this table. Key considerations relating to each of these items is included in the right-hand column.

Cost drivers	Key considerations
Compliance framework	A compliance framework typically consists of a compliance policy, charter, manual and programme. The time taken by the compliance function in the development of the framework and the facilitation of the approval and implementation is captured.
Governance of compliance	Costs will be incurred in relation to governance processes such as preparation for and attendance at governance committee meetings. In terms of leading practice governance principles, the board of directors is ultimately responsible for compliance with AML-CFT requirements. Time spent on the preparation for an attendance at meetings is captured. Management is responsible for compliance, and time taken in discharging responsibilities is accounted for. The compliance function's time spent on assisting stakeholders in governance processes is also captured.
AML-CFT assurance	The costing model provides for the time that is taken by each line of defence in the provision of assurance relating to AML-CFT compliance. First-line-of-defence assurance relating to AML-CFT compliance is undertaken by management. Management will provide such assurance as part of ongoing management processes. The time taken by the compliance function, as part of the second line of defence, relates to compliance monitoring. The third line of defence plays a role in providing independent assurance to governance committees.
AML-CFT systems	Annual systems' related costs comprise depreciation relating to capex and systems maintenance cost for each system. Various components of an AML-CFT programme can be automated through the acquisition or development of systems. These may include systems for client screening, onboarding and ongoing due diligence, transactions monitoring, reporting and record-keeping. The risk-based approach has placed increasing emphasis on the need for AML-CFT-related systems, but investment in systems depends, to a large degree, on the confidence that institutions have in the regulatory framework and the clarity relating thereto. Where systems costs cannot be separately allocated to a specific cost driver, the separate "General AML-CFT Systems" section of the costing model should be completed. However, where different systems have been acquired or developed and costs relating thereto can be separately identified, the systems cost sections of the respective cost driver sections are completed. The cost of AML-CFT systems should be input in the relevant sections of the model according to which the annual depreciation cost is calculated, using the depreciation period that has been input. The annual maintenance cost of the systems is estimated considering the annual cost as percentage of the capex in question.

Onboarding due diligence	Customer onboarding is a first-line-of-defence responsibility. The standard time required to onboard a client for each risk category is determined. This is used to allocate costs considering the hourly rate associated with staff members that undertake such activities, i.e. in relation to the number of clients onboarded in the period under consideration. The measures that are applied by financial institutions in their client acceptance process are used to inform the staff time requirement relating thereto. This will typically include the identification and verification of clients as well as sourcing of information relating to the type of client, considering the products and services used by the client. Further, information is obtained to assess ML-TF risk. Proportionate due diligence measures should be applied. More reliable and independent verification sources/information is required in respect of higher risks. The intensity of onboarding due diligence measures would be increased in relation to higher risks. Accordingly, standard time requirements for each risk classification will be different and the model allows for the determination of different standard times relating thereto. Client screening typically forms part of the onboarding process. In a relatively high-volume and low-value retail business environment, a system will normally be required to undertake screening processes. Risk alerts may also be generated by staff members. Clients that are onboarded will be incorporated into screening protocols, and the proportion of screening hits may be higher than that for ongoing screening that is undertaken in respect of the overall client base, i.e. false positives would still need to be cleared. Where there are screening alerts that cannot be cleared systematically, there should be an escalation process to frontline support staff or compliance to investigate, action and close alerts. The model caters for the estimation of the volume of onboarding client screening alerts and the time needed to address them.
Ongoing due diligence	In a risk-based approach, institutions are required to undertake ongoing due diligence processes that are proportionate to the ML-TF risks that have been identified and assessed. As with onboarding due diligence, ongoing due diligence is a first-line-of-defence responsibility. The standard time required for ongoing due diligence in respect of clients in each risk category is determined. This is used to allocate costs considering the hourly rate associated with staff members that undertake such activities, i.e. in relation to the number of clients for which ongoing due diligence is undertaken in the period under consideration. Staff time will be spent on updating the identification and verification of clients as well as the acquisition of information that relates to the type of client, considering the products and services used by the client. Further, information that is required to assess ML-TF risk and determine proportionate due diligence measures will be obtained. More reliable and independent verification sources/information is required in respect of higher risks. The intensity and frequency of ongoing due diligence measures would be increased in relation to higher risks. Accordingly, standard time requirements for each risk classification will be different, and the model allows for the determination of different standard times relating thereto. Ongoing client screening is needed to keep client information updated and to provide information relating to ML-TF risk over the due diligence lifecycle. This will inform the application of proportionate compliance responses on an ongoing basis. The time requirement relating to ongoing client screening is estimated and input into the model. It is noted that systems may be required to undertake screening in an efficient manner and that staff costs will be incurred to investigate, action and close alerts that are generated by systems and staff members.

Transactions monitoring	In a risk-based approach, institutions will be expected to monitor client transactions to establish whether they are in line with the expected transactions profile for the client. Transactions would typically be monitored using systems in a retail environment, and staff members may identify unusual and suspicious transactions. Staff capacity will be required to address unusual and suspicious transactions, and the standard time taken in this regard is ascertained to estimate the cost of compliance. This may be determined in view of the number of clients (and accounts that they hold) as well as transaction volumes that may generate exceptions, i.e. unusual or suspicious transactions.
Reporting	Reporting requirements will relate to unusual and suspicious transactions, cash threshold requirements, currency reports and any other reporting that is required in terms of regulatory requirements. Reporting may be facilitated via systems or manual processes, and costs will be a function of the volumes in question.
Record-keeping	Institutions must keep records in terms of AML-CFT obligations, i.e. relating to due diligence, transactions monitoring, reporting, training and other matters as appropriate. Costs will be incurred relating to records that are kept electronically or in physical format.
Training	Generic and specific training of staff members is required to assist them to discharge their AML-CFT compliance obligations. Different staff members may require different training, and training requirements will be ongoing. The costs that are incurred will be a function of the time that is set aside by staff members to receive training as well as the cost of the development and delivery of training.
Relationship with regulators/ supervisors	The compliance function will assist management in managing the relationship with regulators/supervisors. The costs will be a function of the amount of time that is required by the respective stakeholders in this regard.

This framework of costs was applied in developing the costing model that was used to facilitate an analysis of the cost of compliance relating to AML-CFT obligations. It was found to be a suitable platform from which to engage with AML-CFT stakeholders in order to estimate the cost of compliance relating to AML-CFT obligations.

Annexure 3: Compliance cost categories

The costing methodology that has been utilised in engaging with project stakeholders has been developed with reference to the OECD Regulatory Compliance Cost Assessment Guidance. This indicates that compliance costs can be categorised under headings that are included in the left-hand column of the table. Key considerations relating to each of these items is included in the right-hand column.

Cost categories	Key considerations
Implementation costs	When regulatory requirements are brought into effect, costs will be incurred in preparations that are made for compliance with the obligations and in developing a framework and process for AML-CFT compliance. There may be a need to develop the organisation's compliance programme and approach relating to regulatory requirements. A change management plan may be required to support compliance initiatives. Such costs are incurred when new regulatory requirements are introduced or a new approach to existing regulatory requirements is implemented.
Staff costs	Staff costs may be direct or indirect and will be incurred by first-, second- and third-line-of-defence staff. Direct costs are reflected in this item and indirect costs are allocated in the following cost category (overheads). The first line of defence is responsible for undertaking all business activities in compliance with applicable regulatory requirements and will include due diligence activities, monitoring, reporting, record-keeping and training. The second line of defence is responsible for assisting management and staff in discharging their responsibilities relating to compliance and in facilitating an appropriate AML-CFT risk management process. The third-line-of-defence costs relate to the provision of independent assurance relating to AML-CFT compliance.
Overheads	Costs will be incurred in support of the activities undertaken by staff members and maintaining systems. Such costs may include premises costs, indirect equipment costs, electricity and water and other utility costs, indirect staff costs and other costs that cannot be directly allocated to AML-CFT measures that are undertaken. Overheads can be allocated in relation to staff costs if these are the main driver thereof. Direct staff costs may be grossed up by an appropriate amount to reflect the costs that are incurred in support of AML-CFT-related activities. For example, where it is established that overheads amount to 10% of direct staff costs, this amount could be allocated to each cost item to represent overhead costs.
Equipment	Equipment may include computer systems, software and machines. The risk-based approach typically requires the support of systems and software in the due diligence, monitoring, reporting and record-keeping elements of an AML-CFT process. Experience has shown that it is usually not practical to rely purely on manual processes where dynamic risk-based approach outcomes are expected. Such costs would be incurred upfront when regulatory requirements change and when needed to keep pace with changing circumstances. Maintenance costs will be incurred on an ongoing basis. Equipment costs will be classified as capital expenditure where there is an enduring benefit therefrom, and depreciation will be charged to the income statement periodically. In some instances, systems costs may be directly attributable to compliance, while in other cases an allocation of costs may be required where the system does not only address compliance requirements.

Materials	Costs may be incurred to acquire materials that are needed for AML-CFT compliance. Such materials could include documentation required to comply with regulatory requirements as part of business processes and training materials needed to train staff. Materials costs are incurred on an ongoing basis.
External services	AML-CFT requirements are often technical in nature and institutions may be concerned about the implications of non-compliance. Accordingly, the services of external consultants may be needed to provide guidance and assist in the development of a compliance framework and process. External service providers may also play a role in the provision of AML-CFT capacity where there are short-term development needs that cannot be met by internal resources.

Annexure 4: Cost-of-compliance base case model

The scenario included in this section of the document is not intended to represent the business or cost profile of any particular institution. It is included purely for discussion purposes and has been developed by the authors with a view to addressing key themes that are relevant from the cost-of-compliance context.

The scenario is used to illustrate the cost of compliance for a typical one-year cost cycle of a hypothetical organisation. In other words, it facilitates the costing of identifiable AML-CFT activities to produce an annual cost picture.

The scenario has been developed with a bank cost-of-compliance context in mind. However, in view of the similar AML-CFT approaches across all institution types, it can be used to broadly illustrate costing themes.

Key features of a hypothetical organisation are described below. These are contained in a series of tables that are used to model selected aspects of the cost of compliance.

Organisation features	Description
Type of organisation	Bank
Description of organisation	The bank offers a suite of corporate, commercial and retail products. The organisation has embarked on a business growth strategy that targets entry-level consumers. The cost of compliance is an important consideration in its business strategy.
Total number of clients	**250,000** This is the total number of clients that are spread across retail, corporate and commercial, and digital business units. The majority of the accounts are found in the retail business unit. The digital business unit has recently been established.
Client base growth/ onboarding rate per annum	**12%** It is assumed that the client base will grow by this percentage each year.
Client base offboarding rate per annum	**5%** It is assumed that clients will be offboarded to this extent each year.

The following risk-rating analysis of the overall client base is assumed for scenario purposes:

Risk rating (from highest to lowest)	Number of clients	Periodic review cycle		% of total client base
		Frequency	Period	
Higher	5,000	1	Year(s)	2%
Standard	50,000	3	Year(s)	20%
Lower	195,000	5	Year(s)	78%

Risk ratings statistics relating to each business unit are included in the table below:

Business Unit	Risk rating			Total
	Higher	Standard	Lower	
Retail	4,770	15,900	37,206	238,500
Corp and Commercial	30	100	234	1,500
Digital	200	667	1,560	10,000

Variables that relate to the cost of compliance are addressed in the table below:

Cost variable	Description
Number of working hours in one year	**2,000 hours** This is a rounded outcome from the assumption that there are 21 working days a month (eight hours per day, for 21 days, each month during the year).
Overhead costs	**10%** This is the percentage that is used to gross up staff costs to consider indirect costs that are incurred in relation to the staff that undertake AML-CFT-related measures.
Systems depreciation period	**4 years** A straight-line depreciation methodology is assumed. In other words, 25% of the systems cost is expensed each year.
Systems annual maintenance cost	**10%** This is the cost that is incurred to maintain systems that are developed or acquired, calculated as a percentage of the development or acquisition cost. In other words, 10% of the cost is incurred each year to maintain the system.

The following staff complement is assumed:

Staff category	Number of staff
Board members	8
CEO	1
Senior management	10
Junior management	31
Compliance officer	6
Internal auditor	7
Supervisory staff	77
Senior Operations staff	91
Junior Operations staff	91
Admin staff	28
Total	350

The hourly staff cost-to-company rates have been determined for staff, the average thereof being USD6.25/hour. The junior operational staff hourly cost is USD5.36.

Assumptions relating to each of the cost drivers that have been identified are set out below.

Compliance framework

The organisation's compliance framework is updated on an ongoing basis. The estimated amount of time required each year is indicated below:

- Policy – 40 hours' compliance officer time
- Charter – 40 hours' compliance officer time
- AML-CFT risk management and compliance programme – 200 hours' compliance officer time

The time referred to above would be spent on updating the framework, engagement with stakeholders, approval of the framework and implementation thereof.

Governance of compliance

Key governance stakeholders and the amount of time that they spend on AML-CFT governance activities on an annual cycle are indicated below:

- Board – 40 hours
- Senior management – 400 hours
- Compliance – 800 hours

The time would be spent on oversight, meeting preparation and attendance at meetings.

AML-CFT assurance

Assurance could be provided by each of the three lines of defence. In the scenario, it is assumed that the time required for assurance activities is as follows:

- Front line – 2,000 hours
- Compliance – 2,000 hours
- Internal audit – 150 hours

The time spent covers assurance planning, engagement, field work, findings, reporting and follow-up needed.

AML-CFT systems

The scenario envisages that the organisation has acquired an AML-CFT screening application and that it has developed a transaction exception reporting system that can identify unusual transactions. These are not sophisticated, and further development of systems capacity is being considered.

It is assumed that the systems acquisition and development cost amounted to USD90,000.

Onboarding due diligence

Institutions must undertake proportionate due diligence measures. In the scenario, this would entail the implementation of an appropriate risk classification process. The scenario envisages a three-point rating scale, i.e. higher risk, standard risk and lower risk. Risks relating to clients would be assessed using an appropriate risk assessment methodology at the time of onboarding. Each client would be subject to due diligence processes that are proportionate to the risks, i.e. the following due diligence levels are applied in the scenario:

- Higher risk – Enhanced due diligence
- Standard risk – Standard due diligence
- Lower risk – Simplified due diligence

Higher levels of due diligence will typically involve additional measures that take more time to undertake. In this regard, it has been assumed that the time commitments in the table below will be required:

Due diligence level	Minutes
Enhanced due diligence	90
Standard due diligence	40
Simplified due diligence	40

Ongoing due diligence

Higher levels of ongoing due diligence will typically involve additional measures that take more time to undertake. In this regard, it has been assumed that the time commitments in the table below will be required:

Due diligence level	Minutes
Enhanced due diligence	30
Standard due diligence	15
Simplified due diligence	15

Client AML-CFT reviews will be undertaken in line with the organisation's review policy as indicated below:

Due diligence level	Timeline
Higher risk	Within 1 year
Standard risk	Within 3 years
Lower risk	Within 5 years

The number of clients that would be reviewed each year is reflected in the table below, i.e. considering the number of accounts in each risk category and the review timeline indicated above:

Due diligence level	Accounts reviewed
Retail	57,876
Corp and Commercial	364
Digital	2,427

Based on the organisation's business and risk profile, most of the compliance effort is focused on retail operations. This is a result of the risk-sensitive due diligence obligations that are imposed in a rules format, i.e. relating to the country identification and verification requirements in place.

Transactions monitoring

The organisation has transactions monitoring capacity that relies on staff member review of transactions that are unusual or suspicious.

If each client has an average of two accounts, and there is an average of four transactions per account, there will be a total of two million transactions. If it is assumed that some 0.5% of the transactions are reviewed and that each one takes 10 minutes to address, this will amount to 1,667 hours of the compliance function's time.

Reporting

Unusual and suspicious transactions are identified by staff members and through systems applications. These are reported to the Financial Intelligence Centre by the compliance function.

It is assumed that there are relatively few suspicious transaction reports in relation to the number of transactions. The reporting takes some 200 hours each year.

Record-keeping

Records are kept in physical files in 100m^2 strong rooms at a cost of USD17.86 per m^2 per annum. Each new client will require a client file (cost of USD0.60) and three printed copies of the due diligence carried out (cost of USD0.04 per page).

Training

Board training (one hour) and senior management training (two hours) are undertaken each year. All staff members receive AML-CFT awareness training each year (two hours), and it is assumed that 10% of the staff receive further specific training (two hours each). Compliance officers receive eight hours of training each year.

Relationship with regulators/supervisors

The compliance function assists organisations in managing their relationship with the AML-CFT authorities. This includes engagement with, and reporting to, the authorities as well as management of interactions or inspections that are undertaken. This takes some 120 hours each year.