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OGGETTO: **COMMISSIONE CONTROLLI INTERNI E GRUPPO DI LAVORO ANTIRICICLAGGIO**
Opinion of the European Banking Authority on the risks of money laundering and terrorist financing affecting the European Union's financial sector

Cordiali saluti

Il Segretario Generale
Alessandro Carretta

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Si inoltra, per opportuna conoscenza della Commissione e del Gruppo di lavoro in oggetto, la Circolare Informativa 21/21 in tema di “Opinion of the European Banking Authority on the risks of money laundering and terrorist financing affecting the European Union’s financial sector”.

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CIRCOLARE INFORMATIVA 21/21 Milano, 5 marzo 2021

OGGETTO: **Opinion of the European Banking Authority on the risks of money laundering and terrorist financing affecting the European Union's financial sector**

Si informa che l'EBA ha pubblicato sul proprio sito l'Opinione in oggetto.

Il documento, allegato per pronto riferimento, è disponibile al seguente indirizzo:
https://www.eba.europa.eu/eba-highlights-key-money-laundering-and-terrorist-financing-risks-across-eu

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Il Segretario Generale
Alessandro Carretta

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EBA/Op/2021/04

3 March 2021

Opinion of the European Banking Authority on the risks of money laundering and terrorist financing affecting the European Union's financial sector

Introduction and legal basis

1. Article 6(5) of Directive (EU) 2015/849[1] requires the EBA to issue an Opinion on the risks of money laundering and terrorist financing (ML/TF) affecting the European Union's financial sector every two years.

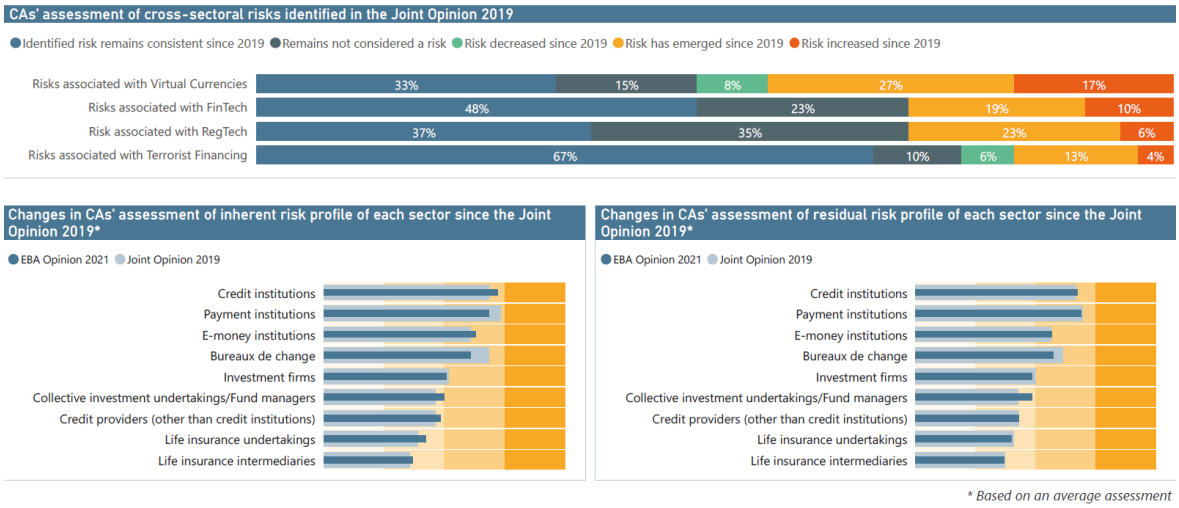
2. This is the third Opinion on the risks of ML/TF affecting the European Union's financial sector. The EBA is issuing this Opinion as part of its new mandate to lead, coordinate and monitor the fight against ML/TF in the financial system at the EU level. The European Securities and Markets Authority (ESMA) and European Insurance and Occupational Pensions Authority (EIOPA) were closely involved in the process.

3. The Opinion draws on information provided by competent authorities (CAs) and on information obtained in the context of the EBAs' work, such as the attendance at AML/CFT colleges and the EBA's AML/CFT implementation reviews.

4. As in its previous Opinion, the EBA looked at ML/TF risks to which credit and financial institutions are exposed, as well as ML/TF risks that cut across various sectors. The EBA also carried out an assessment of how the ML/TF risks have evolved since the last Opinion was published in 2019.

[1] Directive (EU) 2015/849 of the European Parliament and the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (OJ L 141, 5.6.2015, p. 73).

Figure 1: CAs' assessment of risks since the Joint Opinion 2019



** Based on an average assessment*

5. This Opinion sets out proposed actions addressed to CAs, which are based on the detailed analysis and findings set out in the report annexed to the Opinion. The Opinion together with the report also serves to provide information for the European Commission's Supranational Risk Assessment (SNRA) and risk assessments carried out by CAs.

6. The EBA competence to deliver an Opinion is based on Article 29(1)(a) of Regulation (EU) No 1093/2010 and on Article 6(5) of Directive (EU) 2015/849 and Article 16a(1) 29(1)(a) of Regulation (EU) No 1093/2010, as risks of ML/TF affecting the European Union's financial sector relate to the EBA's area of competence.

7. In accordance with Article 14(7) of the Rules of Procedure of the Board of Supervisors, the Board of Supervisors has adopted this Opinion.

8. Under Article 29(1)(a), the EBA has, where appropriate, to conduct open public consultations and a cost-benefit analysis (CBA) and request advice from the Banking Stakeholder Group (BSG). Consultation/CBA must be proportionate to the scope, nature and impact of the Opinion. In this instance, the EBA has not conducted an open public consultation and CBA and has not requested advice from the BSG because the suggestions made to CAs in this Opinion do not change or specify policies, but rather set out good practices and reiterate supervisory duties. In relation to the proposals addressed to the national competent authorities, they would mainly impact the authorities that have already contributed to the development of this Opinion, and so there was no need to seek their views through an open public consultation.

Proposals on cross-sectoral risks

9. The EBA looked at risks that cut across various sectors. These include risks associated with virtual currencies (VCs) and with the services provided through FinTech firms, including RegTech solutions, risks arising from weaknesses in firms' CFT systems and controls, and risks arising from de-risking.

10. The EBA looked furthermore at risks arising from divergent supervisory practices and divergent national legislative frameworks. It assessed in particular risks associated with different approaches to supervision across the EU, with the current lack of a harmonised legal framework setting out clear AML/CFT obligations for crowdfunding service providers and with divergent approaches taken at the national level to tackling market integrity risk associated with tax-related crimes. As part of these cross-sectoral risks, the EBA also identified risks associated with the current COVID-19 pandemic.

Risks associated with virtual currencies

11. As set out in chapter 3.1.1. of the report, a number of CAs reported that risks arising from VCs have increased further since the publication of the last Opinion in 2019. CAs attributed this to the constant growth of the VC market, in terms of both the number of transactions processed and customers. The European financial sector is exposed to the risks arising from VCs mainly in circumstances where customers of regulated credit and financial institutions deal in VCs or where they are virtual asset service providers (VASPs). The main factors contributing to the increased exposure to the ML/TF risks is the limited transparency of VC transactions and the identities of the individuals involved in these transactions. Credit institutions, investment firms, electronic money issuers and payment institutions appear to be the sectors that are most exposed to these risks.

12. The EBA notes that it remains challenging for CAs to stay abreast of market developments and effectively to apply the current legislative framework. This is exacerbated by the number and type of VC activities that currently fall outside of the scope of AMLD5 or Regulation (EU) 2015/847. In this context, as the use of VCs is continually growing, the ESAs are continuing their work to enhance the monitoring of market developments and promote convergence in regulatory and supervisory approaches.

13. In its response to the European Commission's Action Plan for a comprehensive European Union policy on preventing ML/TF,[2] the EBA recommended that the Commission consider the recent revisions to the FATF standards and guidance regarding 'virtual assets' to also include VASPs that are not payment service providers in the scope of Regulation (EU) 2015/847 in order to tackle the risk of criminals using VC systems to transfer value anonymously. The EBA also proposed a consistent authorisation regime and mandatory public register for VASPs in order to reduce divergent practices and support the identification of VASPs that are obliged entities.

14. The European Commission's proposal for a Regulation on Markets in Crypto-assets (MiCA) published in September 2020 will have, if adopted, the effect of expanding the EU regulatory perimeter to a wide range of crypto-asset activities. Further action is expected in 2021 with the publication of the EU's proposals to strengthen the EU's AML/CFT framework, including a proposal to align the scope of the AMLD with the activities covered by MiCA.

[2] EBA report on the future AML/CFT framework in the EU, EBA/REP/2020/25.

15. Given the above findings and observations and although regulation and oversight of VC activities and actors are likely to be further strengthened in the future as a result of ongoing discussions and legislative proposals at EU level, the EBA proposes that CAs closely monitor developments in this area.

16. The EBA furthermore proposes that CAs that have supervisory responsibilities over custodian wallet providers, and over providers engaged in exchange services between virtual and fiat currencies, perform formal sectoral assessments of risks arising from such firms and promote risk awareness and guidance to the firms using available legal tools. The EBA advises CAs to also consider the extent to which financial sectors they supervise are particularly exposed to the risks associated with VCs, for example, because they accept firms dealing with VCs as customers, and take steps to raise awareness of those risks as appropriate.

Risks associated with the provision of financial products and services through FinTech firms

17. As explained in more detail in chapter 3.1.2. of the report, more CAs than in 2019 expressed particular concerns about the provision of financial products and services through Fintech firms that do not fall within the scope of the AML/CFT legislation. CAs indicated that they are concerned about FinTech firms' lack of understanding of their AML/CFT obligations. Some CAs also highlighted risks arising from the use of RegTech solutions by obliged entities, including remote onboarding. In particular, CAs perceived an over-reliance by those obliged entities on outsourcing their AML/CFT compliance to RegTech providers, without putting in place adequate safeguards to ensure that the use of RegTech solutions does not affect their ability to comply with their AML/CFT obligations.

18. The EBA has been actively monitoring the development of the Fintech/RegTech industry and supports the European Commission's Digital Finance Strategy that was published in September 2020. The Strategy sets priority goals and key actions under the principle 'same activity, same risk, same rules'. The EBA also notes that the Commission's recent legislative proposal DORA aims to address the lack of appropriate oversight powers to monitor risks stemming from ICT third-party service providers, including concentration and contagion risks for the EU financial sector.

19. Furthermore, in line with the EBA's work programme on financial innovation, the EBA is currently carrying out a stock-take exercise of various RegTech solutions that are currently available and used by firms across the EU. A separate EBA report on RegTech is due in Q2 2021, which will also provide information on any future policy discussions.

20. Given the above findings and observations, and in order to mitigate the risks associated with FinTech activities and to ensure firms using RegTech solutions meet their AML/CFT obligations, the EBA proposes that CAs familiarise themselves with the technological developments deployed by FinTech and RegTech firms, to understand how they function and what the risks are. CAs could do so in a number of ways, for example, through dedicated training programs for

CAs' staff and/or engagements with FinTech and RegTech providers and firms, even if they are not obliged entities.

Risks arising from weaknesses in CFT systems and controls

21. As explained in detail in chapter 3.1.3. of the report, CAs continue to be concerned about weaknesses in firms' CFT systems and controls. Credit institutions, payment institutions, bureaux de change, e-money institutions and credit providers (other than credit institutions) are the sectors that appear to be most vulnerable to this risk.

22. To address this risk effectively, the EBA proposes that CAs engage in a close and ongoing cooperation with FIUs, law enforcement authorities, and the private sector. As part of the EBA's ongoing work with CAs, the EBA received feedback from several CAs which consider Public-Private-Partnerships (PPPs) to be a fruitful tool to enhance cooperation and information exchange and which contribute to the improvement of reporting of suspicious transaction reports. Some PPPs also include the sharing of tactical information to support on-going investigations by law enforcement authorities. Through PPPs, obliged entities can furthermore adjust their monitoring systems in light of new typologies and risks.

23. The EBA moreover encourages CAs to perform a thorough assessment of sectors' and firms' exposure to TF risks, in particular in situations where these risks appear to have increased, and to perform focused/thematic supervisory reviews of firms to assess the effectiveness of their CFT systems and controls. The EBA reminds CAs that monitoring TF risks goes beyond the monitoring of transactions involving sanctioned persons and entities, and that firms with otherwise limited exposure to the ML risk may nevertheless be exposed to significant TF risks.

Risks arising from de-risking

24. De-risking refers to a decision taken by firms to refuse, or to terminate, business relationship with some categories of customers that they associate with higher ML/TF risk. As explained in more detail in chapter 3.1.5. of the report, based on the responses received from CAs and the input received by the EBA in response to its Call for Input on de-risking,[3] the EBA notes that de-risking continues to pose ML/TF risks, because customers affected by de-risking may resort to alternative payment channels in the EU and elsewhere to meet their financial needs. As a result, transactions may no longer be monitored, making the detection and reporting of suspicious transactions and, ultimately, the prevention of ML/TF more difficult.

25. In addition, a number of respondents to the EBA's 2020 Call for Input suggested that de-risking is a practice that may be caused by firms failing to develop a sufficiently robust and comprehensive business-wide risk assessment and implement controls that effectively manage these risks. They also suggested that firms may choose not to manage the risk associated with individual business relationships and instead discontinuing business relationships with entire

[3] EBA Call for Input on de-risking.

categories of customers. As a result of this practice, certain individuals or entities may be excluded from the financial system.

26. Given the above, the EBA proposes that CAs remind the firms under their supervision that the EBA's Risk Factors Guidelines[4] are clear that the application of a risk-based approach does not require firms to refuse or terminate business relationships with entire categories of customers that are considered to present high ML/TF risk, as the risk associated with individual business relationships may vary, even within one category. The guidelines set out factors that firms should consider when assessing the ML/TF risk associated with a business relationship or occasional transaction and explain the need to carefully balance financial inclusion with the need to mitigate ML/TF risk. As regards the specific issue of corresponding banking relationships, the guidelines furthermore provide detailed guidance to help firms comply with their obligations under the AMLD in an effective and proportionate way.

27. The application of risk-sensitive measures should enable more individuals and businesses to access and use regulated financial services. In the Opinion on the application of customer due diligence measures to customers who are asylum seekers from higher-risk third countries or territories,[5] the EBA has, for example, set out measures that firms can take to comply with AML/CFT requirements in situations where a customer is unable to provide the standard CDD documentation, for example asylum seekers, in order to provide them with an access to basic financial products and services, including a basic bank account. In addition, the EBA is currently reviewing the Risk-based Supervision Guidelines,[6] which will emphasise the importance for competent authorities of developing a good understanding of the ML/TF risk through their sectoral risk assessment and as part of this, developing their understanding of why certain sectors may be affected by de-risking.

28. In light of the above and as de-risking of certain sectors is often caused by the lack of trust in the quality of AML/CFT systems and controls implemented by firms in that sector, the EBA proposes that CAs consider how the level of controls could be improved. This may include increased supervisory activities in the sector or additional guidance to the sector. In addition, the EBA's Risk-based Supervision Guidelines, currently being revised, will require competent authorities to communicate their risk assessment and regulatory expectations in terms of the management of that risk to the sectors to ensure that the risk is managed properly, instead of customers being de-risked.

[4] EBA's Guidelines on customer due diligence and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions ('The ML/TF Risk Factors Guidelines') under Articles 17 and 18(4) of Directive (EU) 2015/849, EBA/GL/2021/02.

[5] EBA's Opinion of the European Banking Authority on the application of customer due diligence measures to customers who are asylum seekers from higher-risk third countries or territories, EBA-Op-2016-07.

[6] ESAs' Joint Guidelines on the characteristics of a risk-based approach to anti-money laundering and terrorist financing supervision, and the steps to be taken when conducting supervision on a risk-sensitive basis, ESAs 2016 72. These guidelines are currently being revised.

29. Furthermore, the EBA encourages CAs that have not yet performed an assessment of de-risking in their jurisdictions to consider performing such an assessment.

Risks arising from supervisory divergence

30. The Joint Opinion 2019 pointed to risk arising from national supervisory approaches and from gaps in the AML/CFT supervisory framework that, if exploited, could have significant implications for the robustness of the EU's AML/CFT defences and for the integrity and stability of the financial market. As set out in chapter 3.2.1. of the report, the EBA notes that CAs' approaches to assessing ML/TF risk in the sectors under their supervision remain inconsistent across the EU. What is more, many CAs appear to find it difficult to supervise their sectors in line with a risk-based approach. This is in line with the EBA's findings in its first report on competent authorities' approaches to the AML/CFT supervision of banks which was published in 2020.[7] There is a risk that, in the absence of adequate risk assessments, CAs may fail to identify, and act upon, ML/TF risks to which their sector is exposed.

31. In its response to the European Commission's Call for Advice on the future of the EU AML/CFT framework, the EBA recommended that, given the importance of ML/TF risk assessments for effective AML/CFT supervision and the need to ensure a consistent and consistently reliable EU-wide approach that produces comparable outcomes, the European Commission enshrines a common approach to ML/TF risk assessments for financial sector supervisors in directly applicable European Union law. This common approach, or methodology, should set out minimum standards and processes that are applicable in all Member States and be complemented at the national level by a more flexible assessment by competent authorities of additional, specific ML/TF risks, taking into account, for example, findings from national risk assessments, differences in the population of financial institutions, the complexity of the sector and the availability of data as appropriate.

32. The EBA's Risk-based Supervision Guidelines set out the steps that CAs should take when conducting supervision on a risk-sensitive basis. In particular, the revised guidelines will provide further guidance to competent authorities on the implementation of the effective risk-based supervision model, including the development of the supervisory strategy and plan which are based on the ML/TF risk assessment. The guidelines will also explain how to select the most effective supervisory tool for specific risk categories of credit and financial institutions.

33. Given the above, the EBA reminds CAs that they have to apply a risk-based approach to AML/CFT supervision under Article 48 of the AMLD. Furthermore, in line with Article 16 of the EBA's founding Regulation, CAs have a legal duty to make every effort to comply with EBA's Risk-based Supervision Guidelines. While these Guidelines are being updated, CAs are expected to have considered the recommendations set out in the EBA's report on competent authorities' approaches to the AML/CFT supervision of banks.

[7] EBA Report on competent authorities' approaches to the AML/CFT supervision of banks, EBA/Rep/2020/06.

Risks associated with crowdfunding platforms

34. CAs' responses presented in chapter 3.2.2. of the report show that the absence of a harmonised legal framework across the EU setting out clear AML/CFT obligations applicable to crowdfunding service providers (CSPs) significantly increases the exposure of crowdfunding services to ML/TF risks. This is in addition to the existing exposure to inherent ML/TF risks associated with crowdfunding platforms (CFPs).

35. While Regulation (EU) 2020/1503 sets up some AML/CFT requirements in terms of due diligence of CSPs in respect of project owners (Art. 5(2)(a)) and within authorisation procedures (Art. 8(3)(a)), the lack of a harmonised legal framework setting up clear AML/CFT obligations for CSPs is creating gaps in the EU's AML/CFT defences. While the EBA notes the legislator's intention set out in Regulation (EU) 2020/1503 to re-assess the treatment of CSPs and CFPs for AML/CFT purposes within the next two years, the EBA remains concerned about the risks associated with CSPs and CFPs and the lack of legal certainty relating to the AML/CFT obligations.

36. The EBA, in its response to the European Commission's Call for Advice on the new EU AML/CFT framework, proposed that the Commission anticipate this assessment, and carry it out at the same time as it carries out its review of the EU's legal AML/CFT framework.

37. In light of the above findings and observation, the EBA proposes that CAs monitor closely the legal developments related to the treatment of CSPs and CFPs for AML/CFT purposes.

38. Furthermore, the EBA invites CAs to assess risks associated with crowdfunding in their jurisdiction, even where CFPs and CSPs are not obliged entities, as these risks may have an impact on regulated services. For example, CSPs require a bank account to provide their services, as a result of which laundered funds may be introduced into the regulated financial system. In addition, in respect of those CFPs and CSPs that are obliged entities, CAs should consider whether further communication is necessary that sets out clearly the CAs' regulatory expectations in respect of the sector as well as the risks to which CFPs and CSPs are exposed. CAs are invited, in doing so, to refer to the EBA's Risk Factors Guidelines and EBA's Risk-based Supervision Guidelines.

Risks arising from divergent approaches to tackling tax-related crimes

39. As explained in chapter 3.2.3. of the report, facilitating tax crimes, or handling proceeds from tax crimes, undermines the integrity of the EU's financial system, and the approaches taken by CAs to tackle market integrity risk arising from tax-related crimes diverge significantly. The EBA has observed significant divergence across the EU in terms of what practices are considered tax crimes under national laws. Furthermore, while cooperation with tax authorities seems to take place in some cases, a formal protocol for cooperation is still lacking in some Member States to ensure a sound exchange of information between AML/CFT supervisors and their counterparts in tax authorities.

40. In light of the above findings, the EBA proposes that CAs assess, as part of their ML/TF risk assessment, how vulnerable different sectors under their supervision are to ML arising from predicate tax crimes. Where appropriate, competent authorities should consider adjusting their supervisory practices in line with the risks identified.

41. CAs are furthermore reminded that cooperation is required under the AMLD, as amended through AMLD5. The EBA proposes that CAs should therefore ensure, to the extent permitted under national law, regular and timely exchange of information with the tax authorities in their Member State. This would allow CAs and tax authorities to develop a better understanding of how certain sectors or the financial sector as a whole can be vulnerable to money laundering arising from tax crimes.

42. The EBA furthermore reminds CAs that in its report on competent authorities' approaches to tackling market integrity risk associated with dividend arbitrage schemes,[8] the EBA sets out a number of expectations of credit institutions and competent authorities under the current regulatory framework. These expectations included inter alia:

- AML supervisors taking account of the risks highlighted by the dividend arbitrage cases in their assessment of AML systems and controls; and
- greater cooperation arrangements between AML supervisors and tax authorities to facilitate the exchange of information regarding tax crimes.

43. CAs should therefore apply the recommendations made in the EBA report in particular by:

- setting out regulatory expectations in guidance to firms;
- carrying out targeted inspections in cases of concern, or conducting a fact-finding thematic review of several institutions to provide information on the CAs' understanding of the nature and scale of the risks attaching to tax crimes.

Risks arising from the COVID-19 pandemic

44. As developed in chapter 3.3. of the report, the COVID-19 pandemic illustrates how new ML/TF risks may emerge unexpectedly. The EBA notes in that regard that several associated risks are relevant from an AML/CFT perspective. The reduction in some firms' revenues as a result of the pandemic may for instance have had a negative impact on the firms' AML/CFT compliance. Furthermore, an increased on-boarding of customers remotely due to restrictions on movement by firms, which may not be accustomed to remote on-boarding otherwise, may expose the financial sector to additional ML/TF risks. Since the start of COVID-19 pandemic, firms had to adapt quickly and there are concerns that some might not be sufficiently well equipped to mitigate resulting ML/TF risks effectively. The current pandemic also gave rise to new crime typologies, such as misuse of government funds, in particular in relation to the quick

[8] EBA report on competent authorities' approaches to tackling market integrity risks associated with dividend arbitrage trading schemes, April 2020, EBA/REP/2020/15.

disbursement of Covid-relief funds which firms under pressure to pay out may be ill-equipped to manage, and frauds related to the sale of medical products, which firms may have found difficult to integrate quickly in their monitoring systems. Furthermore, the EBA notes that firms that face financial difficulties may change their customer base, products and services or expand in geographies that are associated with higher ML/TF risks, without necessarily being adequately equipped to manage these risks. The COVID-19 pandemic also affects the supervisory work of CAs, requiring CAs to make adjustments to their supervisory activities and plans, with most CAs conducting their supervisory activities remotely by carrying out virtual inspections and engagements with firms under their supervision.

45. Given the above and in line with the EBA's Risk based Supervision Guidelines, which are currently being revised, the EBA reminds CAs that they should have processes in place to identify and monitor emerging risks in their respective jurisdiction and to review and adjust their supervisory approach and strategy accordingly, where necessary. Moreover, while a large proportion of CAs reported to the EBA that they use innovative, online means to ensure continued supervision of firms, the EBA reminds all CAs that they should ensure that they maintain an adequate level of AML/CFT supervision as off-site supervision on its own may not be sufficient in all cases. However, when restrictions are lifted, the EBA encourages CAs to resume their on-site activities on a risk-sensitive basis to acquire a good understanding of firms' culture and governance.

46. While most CAs appear to be well aware of the evolving crime typologies induced by the COVID-19 pandemic and, in most instances, have communicated this also to the relevant financial sectors, the EBA reminds CAs, in line with its statement published in March 2020,[9] of the importance of cooperation with the private sector, FIUs and law enforcement authorities in this process. Since the pandemic is not over yet, the EBA encourages CAs to continue monitoring the risks accordingly and to cooperate with various stakeholders to remain updated on developments.

47. As firms have resorted increasingly to the remote onboarding of customers due to the restrictions on movement imposed during the pandemic, the EBA also proposes that CAs ensure that, when firms under their supervision apply remote onboarding solutions for CDD purposes, they do so effectively and without compromising the quality of their CDD. For guidance on the adequate safeguards that should be put in place when using innovative CDD solutions, CAs are advised to refer to the ESAs' Joint Opinion on innovative solutions.[10] The Opinion sets out the steps that firms can take to ensure a safe use of these solutions, including in cases where the customer is not physically present and in situations where the ML/TF risk is increased. In its revised Risk Factors Guidelines, the EBA simplified the requirements around the use of non-face-to-face interactions to help firms assess and manage the risks associated therewith.

[9] EBA statement on actions to mitigate financial crime risks in the COVID-19 pandemic, 31 March 2020

[10] ESAs' Opinion on the use of innovative solutions by credit and financial institutions in the CDD, JC2017 81.

48. Furthermore, the European Commission recently invited the EBA to draft guidelines on the key elements related to customer remote onboarding and reliance on CDD processes carried out by third parties. The guidelines will be published for consultation by the end of 2021.

49. The EBA also proposes that CAs ensure that the exchange of information between CAs and prudential supervisors is maintained so that CAs can ensure that sufficient safeguards are put in place by firms to mitigate potential risks effectively. Prudential supervisors may be the first to know about any changes to firms' profitability or business model that have occurred as a result of the COVID-19 pandemic. The EBAs' Risk-based Supervision Guidelines provide that AML/CFT supervisors should liaise with their prudential counterparts to ensure that they remain informed of any changes that could have a bearing on an institutions' ML/TF risk profile. Equally, in 2021, the EBA will publish draft guidelines under Article 117 of the CRD on cooperation and information exchange between prudential supervisors, AML/CFT supervisors and financial intelligence units, which will further emphasise the need for cooperation and explain how and when this cooperation should take place.

Proposals on risks in each sector

Credit institutions

50. As developed in chapter 4.1. of the report, the EBA notes that CAs have assessed the inherent ML/TF risk in the credit institutions (CIs) sector as significant or very significant. CAs appeared to be generally satisfied with the quality of controls put in place by CIs to mitigate the inherent risks. However, many CAs also identified persisting deficiencies in some key controls, for example the effectiveness of firms' transaction monitoring systems and effectiveness of STRs reporting. These deficiencies were already raised in the Joint Opinion 2019, suggesting that despite the supervisory efforts provided by CAs and the improving trend in the adequacy and quality of overall controls, further improvement is still required. Compared with other sectors, the EBA notes that the sector is the one that receives the most coverage in terms of supervisory activities. This is in line with the risk-based approach to supervision, which requires the intensity of the supervision to be adjusted in line with the ML/TF risk exposure of the sector. It may also be explained by the fact that CIs have a gate-keeper role, preventing entry to other financial services.

51. In light of the above, the EBA proposes that CAs monitor closely the management of ML/TF risk by CIs and if necessary, strengthen their supervisory efforts with more intrusive supervision in those firms that present the most significant ML/TF risks. To ensure adequate supervisory coverage of all firms, the EBA furthermore proposes that CAs consider using a broader variety of on-site or, in the current pandemic, virtual tools in particular, as effective AML/CFT supervision does not mean full-scope inspections in all cases. Where CAs identify widespread compliance failures or weaknesses in respect of a particular aspect of firms' AML/CFT controls, they should consider setting clear regulatory expectations and, where necessary, consider whether additional guidance over and above that set out in the EBA's Risk Factors Guidelines would be appropriate. CAs should consult the EBA's Risk-based Supervision Guidelines, currently

being revised, which provide further guidance on different supervisory tools and what factors should be considered in order to select the more effective tool for a particular firm or sector.

52. The EBA moreover encourages CAs to monitor closely the evolution of key emerging risks identified in the sector, such as those associated with FinTech (including RegTech solutions) and those associated with the current pandemic, as detailed in the relevant cross-sectoral section above.

Payment institutions

53. As set out in chapter 4.2. of the report, the EBA notes that CAs have assessed the sector of payment institutions (PIs) as presenting significant or very significant inherent risks. While CAs noted an improvement in the level of controls in place in this sector, a large proportion of these controls are still rated as poor or very poor. Despite a significant risk profile and although almost all CAs indicated they carried out some supervisory activity during the period under review, the EBA notes that the sector, in view of its risk profile, saw a relatively low level of supervisory activity. Most of the activities were carried out off-site, mainly through AML/CFT returns and scheduled reviews. On-site activities, on the other hand, were mostly performed via on-site engagements that include bilateral meetings with the firm's personnel, but stopped short of more intrusive on-site inspections and scheduled full-scope inspections.

54. In light of the concerns raised by CAs about the effectiveness of certain controls in the sector and the overall unsatisfying improvements made in that regard since the Joint Opinion 2019, the EBA proposes that CAs engage further with the sector and consider whether the intrusiveness of their supervision in this sector may need to be enhanced in line with the level of ML/TF risks by, for example, focusing more on on-site supervision.

E-money institutions

55. As set out in chapter 4.3. of the report, the EBA observes that most CAs considered the e-money institutions (EMIs) sector to present significant or moderately significant inherent ML/TF risks. A significant proportion of CAs indicated they had not assessed the controls in place in the sector and for those that assessed these controls, the quality of many of them remained of concern to CAs. In their supervision of the sector, CAs indicated they mostly relied on off-site supervision, mainly through AML/CFT returns, and used very little on-site supervision.

56. Given the above findings, the EBA encourages CAs to carry out more robust risk assessment of the sector to the extent that EMIs are active on their territory, clearly identifying and assessing all ML/TF risk factors, considering the provisions of Article 7 of the Directive (EU) 2015/849 that require Member States to take appropriate steps to identify, assess, understand and mitigate the risks of ML/TF risks affecting them. Because the sector is assessed as presenting high ML/TF risk, CAs are moreover advised to consider how they can use a mix of different supervisory tools to supervise the sector more efficiently and in line with that risk profile. While full-scope on-site inspections may not be necessary in every case, CAs should consider how they can use, for

instance, on-site thematic reviews to ensure adequate supervisory coverage of a sufficiently large number of firms.

57. The EBA furthermore suggests to CAs that they use the EBA's Risk Factors Guidelines to provide the sector with appropriate guidance setting out their regulatory expectations, mainly in terms of individual business relationship, ML/TF risk assessments and the monitoring systems firms should put in place as a risk mitigation tool, including domestic typologies addressing specifically the business of EMIs.

Bureaux de change

58. As set out in chapter 4.4. of the report, the EBA notes that the majority of CAs considered the bureaux de change (BdC) sector as presenting significant and very significant risks from an inherent risk perspective. CAs did however express very different views on the risk profile of the sector. A significant number of authorities indicated they did not assess the controls in place in this sector and most authorities that assessed the controls in place rated them as poor overall. A significant proportion of authorities indicated they had not performed any supervisory engagements of any type.

59. In light of the above, the EBA reminds CAs that they are required to have a good understanding of ML/TF risks associated with all sectors under their supervision. In light of the significant risk exposure within this sector, which is coupled with the poor quality of controls, the EBA suggests that CAs that have not carried out a formal risk assessment of the BdC sector take adequate steps to carry out such an assessment. In addition, CAs are advised to review their supervisory strategy and plan to ensure that the supervisory activities in this sector are commensurate with the ML/TF risk assessment and make adjustments to their existing plans if necessary.

60. The EBA moreover proposes that CAs consider which tools they can use in line with the CAs' risk-based approach, and give due consideration to thematic inspections to get a broad understanding of risks and the quality of risk mitigation efforts in the sector. CAs are also advised to bring to the sector's attention the EBA's new sectoral guidance on BdC, which is included in the EBA's Risk Factor Guidelines.

61. EBA also proposes that CAs pay close attention to the possibility of quality of controls deteriorating in the sector, as the COVID-19 pandemic may affect the demand for cash-based currency exchange service and may lead some firms to embrace riskier business models, or otherwise increase their ML/TF risk appetite.

Investment firms

62. As set out in chapter 4.5. of the report, the EBA notes that CAs have rated the overall inherent risk of the sector of investment firms as moderately significant. Overall, CAs have assessed the quality of controls within the sector as good. However, CAs indicated that a number of key controls for the sector, such as those related to ongoing monitoring and STR reporting, continue to be assessed as poor. The EBA also notes that CAs indicated that AML/CFT returns were the

most used supervisory tool in the sector and that a small proportion of authorities indicated they did not carry out any off-site/on-site inspections in the period under review.

63. Given the findings above, the EBA advises CAs to ensure a thorough understanding of the risks faced by the sector through measures, including the completion of AML/CFT returns by firms, analysis of the risks identified through both the National Risk Assessment and the Supranational Risk Assessment, FATF publications and other reliable sources of information. This should be conducive to a more effective use of resources and the application of a risk-based approach.

64. The EBA also proposes that CAs consider whether to increase the proportion of reviews they carry out on-site in light of the risks and control weaknesses they have identified. CAs are particularly expected to take concrete actions to ensure that firms have robust controls to carry out transaction monitoring and to submit STRs when necessary. Since weaknesses in transaction monitoring controls were already identified in the Joint Opinion 2019, the little improvements made since suggest that further actions are needed to ensure that the sector has better controls in this regard.

Collective investment undertakings/fund managers

65. As set out in chapter 4.6. of the report, the EBA notes that most CAs considered the sector as presenting a moderately significant inherent risk profile. However, the EBA observes that a large number of CAs cited the sector's exposure to cross-border transactions as an area of concern. The EBA furthermore observes that while CAs generally rated the quality of controls as good, a sizeable proportion of them assessed some controls as being poor, such as those related to transaction monitoring and STR reporting. Furthermore, the EBA observes that a significant proportion of CAs indicated they had not assessed controls related to either the adequacy or the effectiveness of governance structures. Finally, the EBA also notes that the overall supervisory activity within this sector remains relatively low and the majority of supervisory activities appear to be based on AML/CFT returns.

66. In light of the above, the EBA proposes that CAs consider how best to address the identified weaknesses in controls put in place by firms as part of their supervisory approach. This may include, for example, considering the most effective supervisory tools to mitigate risk arising from these weaknesses, such as thematic or targeted reviews.

67. The EBA moreover encourages CAs to increase their supervisory focus on governance within this sector to ensure that firms are implementing appropriate oversight and management of their AML/CFT control frameworks. The EBA therefore encourages CAs to enhance cooperation with prudential CAs to ensure that risks that are common to both CAs are appropriately identified and addressed.

68. The EBA also reminds CAs that while AML/CFT returns are an effective supervisory tool for gathering data on risks associated with individual firms, they do not provide sufficiently reliable information on the quality and effectiveness of mitigating measures put in place by firms. Therefore, they do not replace the need for risk-based on-site or off-site supervision. The EBA

encourages CAs to assess the supervisory tools at their disposal to ensure that the most effective tool is selected for the supervision of this sector, which allows competent authorities to develop a broad understanding of residual risk within the sector, for example, thematic reviews. To develop better understanding of different supervisory tools, competent authorities should refer to the EBAs' Risk-based Supervision Guidelines, which are currently being revised.

69. The EBA furthermore encourages CAs to consider whether cross-border risks are appropriately captured and given adequate weighting in their risk assessment of the sector.

Credit providers (other than credit institutions)

70. As set out in chapter 4.7. of the report, the EBA notes that most CAs considered the level of inherent risk in the sector of credit providers (CPs) to be moderately significant or less significant. The EBA furthermore observes that CAs rated the quality of controls in the sector as good overall. However, the EBA notes that a significant share of CAs indicated these controls had not been assessed and that the supervisory activity in the sector is mostly conducted on an off-site basis.

71. In light of the above findings and keeping in mind the diverse nature of the sector, the EBA proposes that CAs identify the main risks in each sub-sector, for instance consumer CPs, factoring, leasing and commercial CPs, including trends and emerging risks in each of them. In line with a risk-based approach, the EBA advises CA to focus their supervisory attention on the areas which represent the highest ML/TF risk in this sector.

Life insurance undertakings

72. As set out in chapter 4.8. of the report, the EBA notes that CAs considered the sector of life insurance undertakings (LIUs) as presenting moderately significant or less significant risk from an inherent ML/TF risk perspective. A small proportion of CAs however indicated that the sector presented significant risks. The EBA observes that a large proportion of CAs indicated they had not assessed the quality of controls put in place in the sector, and those that had done so have assessed the controls put in place by firms in the sector as good overall. The EBA underlines that the sector has received a relatively low level of supervisory activity which is in line with the risk-based approach and the sector is mostly supervised through AML/CFT returns.

73. In light of the above, the EBA proposes that CAs obtain sufficient information on the quality of controls to ensure a comprehensive understanding of the sector. While the supervisory activities in the sector appear to be in line with the level of the risk profile of LIUs, the EBA notes that the large proportion of CAs that indicated they had not carried out any assessment of controls in place in the sector may result in a distorted perception of the overall risk of the sector.

74. In line with the risk-based approach, EBA furthermore encourages CAs to find the most effective supervisory tools to supervise this sector. The sector is diverse and not all life insurance products are low risk. The EBA therefore advises CAs to have a good understanding of the risks associated with life insurance products offered in their Member States, as it is evident that intense

supervision of this sector is required in those Member States that have rated this sector as presenting significant risk.

75. The EBA also proposes that CAs identify and assess emerging risks in the sector. As developed in the above section on risks associated with FinTech, the EBA recommends that CAs train themselves to understand the risks associated with the use of RegTech solutions. CAs are furthermore encouraged to assess the ML/TF risks linked to new technologies in this sector and adjust their supervisory approach if necessary, for example by carrying out a thematic review to assess how the risk is mitigated across the sector.

Life insurance intermediaries

76. As developed in chapter 4.9. of the report, the EBA notes that CAs considered the sector of life insurance intermediaries (LIIs) as presenting less significant exposure to ML/TF inherent risks. The EBA notes that while, when assessed, the controls put in place in the sector were rated as good or very good overall, a significant proportion of CAs indicated they had not assessed the quality of controls put in place in the sector. The EBA also observes that the sector has received low levels of supervisory activities and that a large number of CAs responsible for the AML/CFT supervision of the sector indicated they did not carry out any supervisory activity in this sector.

77. In light of the above findings, the EBA reminds CAs that, in line with the risk-based approach, CAs are required to have a good understanding of ML/TF risks present in all sectors, including those presenting a less significant risk of ML/TF. Therefore, the EBA encourages CAs to obtain sufficient information in order to understand the risks and vulnerabilities and to assess risk in this sector. In particular, the EBA advises CAs to stay informed of any changes in the sector that may result in exposing the sector to increased ML/TF risks. For example, CAs should understand the risks linked to the increasing use of Fintech solutions used in the sector and assess the controls set up by the LII sector when carrying out remote onboarding.

78. The EBA also advises CAs to identify the most effective supervisory tools for this sector. Considering that LIIs present a less significant risk profile, the EBA invites CAs to consider the most appropriate tools for the supervision of the sector, for example targeted inspections.

This Opinion will be published on the EBA's website.

Done at Paris, 3 March 2021

[signed]

José Manuel Campa

Chairperson
For the Board of Supervisors

EBA REPORT

ON MONEY LAUNDERING AND TERRORIST FINANCING RISKS AFFECTING THE EUROPEAN UNION'S FINANCIAL SECTOR

EBA EUROPEAN BANKING AUTHORITY

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Abbreviations

AMLD	Anti-Money Laundering Directive
AML	Anti-Money Laundering
CA	Competent Authority
CFP	Crowdfunding Platform
CSP	Crowdfunding Service Provider
CFT	Countering the financing of terrorism
FATF	Financial Action Task Force
ML	Money Laundering
MONEYVAL	Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism
MoU	Memorandum of Understanding
NPO	Not-for-Profit Organisation
NRA	National Risk Assessment
PEP	Politically Exposed Person
SNRA	Supranational Risk Assessment
TF	Terrorist Financing
UBO	Ultimate Beneficial Owner
VASP	Virtual Asset Provider
VCs	Virtual Currencies

Executive Summary

1. Article 6(5) of Directive (EU) 2015/849 (AMLD4) requires the EBA to issue an Opinion on the ML/TF risks affecting the EU's financial sector every two years. This Opinion is the third edition and serves to inform Member States' competent authorities in their application of the risk-based approach to AML/CFT supervision and the European Commission's Supranational Risk Assessment.

2. This report, which is annexed to the Opinion, is based on the views expressed by national competent authorities through a questionnaire related to ML/TF risks and supervisory activities carried out by these authorities in 2018 and 2019. The questionnaire was sent to the 57 authorities responsible for the supervision of firms' compliance with their AML/CFT obligations in the EU Member States and European Economic Area (EEA) countries. It also draws on information obtained in the context of the EBA's work.

3. Similar to the previous Joint Opinion published in 2019, and to ensure comparability and facilitate the identification of trends over time, the EBA has grouped the risks that were identified throughout this process into two broad categories: cross-sectoral risks and sector-specific risks.

Cross-sectoral risks

4. The first part of the report covers the cross-sectoral ML/TF risks. In this part the EBA has carried out an assessment of how the risks identified in the Joint Opinion published in 2019 have evolved since then. In particular, the EBA looked at the following:

    - ML/TF risks associated with virtual currencies, where a number of CAs reported that risks arising from VCs have increased further since the publication of the last Opinion in 2019. CAs attributed this to the constant growth of the VC market, in terms of both the number of transactions processed and customers. The European financial sector is exposed to the risks arising from VCs mainly in circumstances where customers of regulated credit and financial institutions deal in VCs or where they are virtual asset service providers (VASPs). The main factors contributing to the increased exposure to the ML/TF risks are the limited transparency of VC transactions and the identities of the individuals involved in these transactions. Credit institutions, investment firms, electronic money issuers and payment institutions appear to be the sectors that are most exposed to these risks.

    - Risks associated with FinTech, where more CAs than in 2019 expressed particular concerns about the provision of financial products and services through Fintech firms that do not fall within the scope of the AML/CFT legislation. CAs indicated that they are concerned about the lack of understanding of their AML/CFT obligations by FinTech firms. Some CAs also highlighted risks arising from the use of RegTech solutions by obliged entities, including

remote onboarding. In particular, CAs perceived an over-reliance by those obliged entities on outsourcing their AML/CFT compliance to RegTech providers, without putting in place adequate safeguards to ensure that the use of RegTech solutions does not affect their ability to comply with their AML/CFT obligations.

- Terrorist financing risks, where CAs continue to be concerned about weaknesses in firms' CFT systems and controls. Credit institutions, payment institutions, bureaux de change, e-money institutions and credit providers (other than credit institutions) are the sectors that appear to be most vulnerable to this risk. Several competent authorities identified in addition particular concerns related to the use of virtual currencies and crowdfunding platforms for terrorist financing purposes.

- Risks arising from the withdrawal of the United Kingdom (UK) from the EU, where in the Joint Opinion 2019, CAs identified ML/TF risks that were largely related to the relocation of financial institutions from the UK to Member States. CAs did not raise additional concerns and the risk perception did not change significantly since then.

- Risks arising from de-risking, where responses received from CAs and the input received by the EBA in response to its Call for Input show that the practice of de-risking continues to pose ML/TF risks, in particular because customers affected by de-risking may resort to alternative payment channels in the EU and elsewhere to meet their financial needs. As a result, transactions may no longer be monitored, making the detection and reporting of suspicious transactions and, ultimately, the prevention of ML/TF more difficult.

5. In this cross-sectoral part, the report furthermore sets out risks associated with divergent supervisory practices and legislative divergences across the EU. In particular:

- It assesses the adequacy of the application of a risk-based approach across the financial sector. Many CAs appear to find it difficult to supervise their sectors in line with a risk-based approach. There is a risk that, in the absence of adequate risk assessments, CAs may fail to identify, and act upon, ML/TF risks to which their sector is exposed.

- It sets out the risks associated with the current AML/CFT framework, or lack thereof, for the supervision of crowdfunding platforms. The report points out in particular that the absence of a harmonised legal framework setting out clear AML/CFT obligations applicable to crowdfunding service providers (CSPs) significantly increases the exposure of crowdfunding services to ML/TF risks. This is in addition to the existing exposure to inherent ML/TF risks associated with crowdfunding platforms (CFPs).

- It looks at the divergent approaches taken by CAs to tackling market integrity risk associated with tax-related crimes. The EBA has observed significant divergence across the EU in terms of what practices are considered tax crimes under national laws. Furthermore, while cooperation with tax authorities seems to take place in some cases, a formal protocol for

cooperation is still lacking in some Member States to ensure a sound exchange of information between AML/CFT supervisors and their counterparts in tax authorities.

6. The last section of the cross-sectoral part assesses the risks associated with the current COVID-19 pandemic. The EBA notes in that regard that several associated risks are relevant from an AML/CFT perspective. The reduction in some firms' revenues as a result of the pandemic may for instance have had a negative impact on the firms' AML/CFT compliance. Furthermore, an increased on-boarding of customers remotely due to restrictions on movement by firms, which may not be accustomed to remote on-boarding otherwise, may expose the financial sector to additional ML/TF risks. Since the start of COVID-19 pandemic, firms had to adapt quickly and there are concerns that some might not be sufficiently well equipped to mitigate resulting ML/TF risks effectively. The current pandemic also gave rise to new crime typologies, such as misuse of government funds, in particular in relation to the quick disbursement of Covid-relief funds which firms under pressure to pay out may be ill-equipped to manage, and frauds related to the sale of medical products, which firms may have found difficult to integrate quickly in their monitoring systems. Furthermore, the EBA notes that firms that face financial difficulties may change their customer base, products and services or expand in geographies that are associated with higher ML/TF risks, without necessarily being adequately equipped to manage these risks. The COVID-19 pandemic also affects the supervisory work of CAs, requiring CAs to make adjustments to their supervisory activities and plans, with most CAs conducting their supervisory activities remotely by carrying out virtual inspections and engagements with firms under their supervision.

ML/TF risks in each sector

7. The second part of the report focuses on the assessment of the ML/TF risks in each of the financial sectors:

- Credit institutions, where CAs have assessed the inherent ML/TF risk in the sector as significant or very significant. CAs appeared to be generally satisfied with the quality of controls put in place by CIs to mitigate the inherent risks. However, many CAs also identified persisting deficiencies in some key controls, for example the effectiveness of firms' transaction monitoring systems and the effectiveness of STR reporting. These deficiencies were already raised in the Joint Opinion 2019, suggesting that despite the supervisory efforts provided by CAs and the improving trend in the adequacy and quality of overall controls, further improvement is still required. Compared with other sectors, the sector is the one that receives the most coverage in terms of supervisory activities. This is in line with the risk-based approach to supervision, which requires the intensity of the supervision to be adjusted in line with the ML/TF risk exposure of the sector. It may also be explained by the fact that CIs have a gate-keeper role, preventing entry to other financial services.

- Payment institutions, where CAs have assessed the sector as presenting significant or very significant inherent risks. While CAs noted an improvement in the level of controls in place

in this sector, a large proportion of these controls are still rated as poor or very poor. Despite a significant risk profile and although almost all CAs indicated they carried out some supervisory activity during the period under review, the sector, in view of its risk profile, saw a relatively low level of supervisory activity. Most of the activities were carried out off-site, mainly through AML/CFT returns and scheduled reviews. On-site activities, on the other hand, were mostly performed via on-site engagements that include bilateral meetings with the firm's personnel, but stopped short of more intrusive on-site inspections and scheduled full-scope inspections.

- E-money institutions, where most CAs considered the sector to present significant or moderately significant inherent ML/TF risks. A significant proportion of CAs indicated they had not assessed the controls in place in the sector and for those that assessed these controls, the quality of many of them remained of concern to CAs. In their supervision of the sector, CAs indicated they mostly relied on off-site supervision, mainly through AML/CFT returns, and used very little on-site supervision.

- Bureaux de change, where the majority of CAs considered the sector as presenting significant and very significant risks from an inherent risk perspective. CAs did however express very different views on the risk profile of the sector. A significant number of authorities indicated they did not assess the controls in place in this sector, and most authorities that assessed the controls in place rated them as poor overall. A significant proportion of authorities indicated they had not performed any supervisory engagements of any type.

- Investment firms, where CAs have rated the overall inherent risk of the sector as moderately significant. Overall, CAs have assessed the quality of controls within the sector as good. However, CAs indicated that a number of key controls for the sector, such as those related to ongoing monitoring and STR reporting, continue to be assessed as poor. CAs indicated that AML/CFT returns were the most used supervisory tool in the sector and a small proportion of authorities indicated they did not carry out any off-site/on-site inspections in the period under review.

- Collective investment undertakings/fund managers, where most CAs considered the sector as presenting a moderately significant inherent risk profile. However, a large number of CAs cited the sector's exposure to cross-border transactions as an area of concern. While CAs generally rated the quality of controls as good, a sizeable proportion of them assessed some controls as being poor, such as those related to transaction monitoring and STR reporting. Furthermore, a significant proportion of CAs indicated they had not assessed controls related to either the adequacy or the effectiveness of governance structures. The overall supervisory activity within this sector remains relatively low and the majority of supervisory activities appear to be based on AML/CFT returns.

- Credit providers, where most CAs considered the level of inherent risk in the sector to be moderately significant or less significant. CAs rated the quality of controls in the sector as

good overall. However, a significant share of CAs indicated these controls had not been assessed and that the supervisory activity in the sector is mostly conducted on an off-site basis.

- Life insurance undertakings, where CAs considered the sector as presenting moderately significant or less significant risk from an inherent ML/TF risk perspective. A small proportion of CAs however indicated that the sector presented significant risks. A large proportion of CAs indicated they had not assessed the quality of controls put in place in the sector, and those that had done so have assessed the controls put in place by firms in the sector as good overall. The sector has received a relatively low level of supervisory activity which is in line with the risk-based approach and the sector is mostly supervised through AML/CFT returns.

- Life insurance intermediaries, where CAs considered the sector as presenting less significant exposure to ML/TF inherent risks. While, when assessed, the controls put in place in the sector were rated as good or very good overall, a significant proportion of CAs indicated they had not assessed the quality of controls put in place in the sector. The sector has received low levels of supervisory activities and a large number of CAs responsible for the AML/CFT supervision of the sector indicated they did not carry out any supervisory activity in this sector.

1. Background and legal basis

1. Article 6(5) of Directive (EU) 2015/849 (AMLD4) requires the EBA to issue an Opinion on the ML/TF risks affecting the EU's financial sector.

2. The Opinion is based on the findings of the present report, which covers the nine sectors in the remit of the EBA: credit institutions; payment institutions; e-money institutions; bureaux de change; investment firms; fund managers; credit providers (other than credit institutions); life insurance undertakings and life insurance intermediaries.

2. Methodology

3. In drafting this report, the EBA took into account the views expressed by CAs through a questionnaire related to ML/TF risks and supervisory activities carried out in 2018 and 2019. The questionnaire was sent to the 57 Competent Authorities (CAs) responsible for the supervision of firms' compliance with their AML/CFT obligations in the EU Member States and European Economic Area (EEA) countries.

4. The questionnaire was similar to the one used for the preparation of the Joint Opinion 2019. Keeping similar sets of questions aimed at facilitating direct comparisons and the identification of trends over time. However, in the questionnaire prepared for the CAs, the EBA took into account that, compared to the previous Opinion, the EBA regulatory technical standards and guidelines now apply and have been fully implemented in all Member States. As a result, more detailed questions were added to the questionnaire, as it could be expected that more granular information could be obtained at this stage.

5. In total, 52 CAs submitted their input, two of which submitted coordinated contributions with their counterparts in the same jurisdiction, so in effect representing 54 authorities. In some jurisdictions, the supervision of AML/CFT is divided between a number of different CAs, whereas in others, this is the responsibility of one CA. In addition, in some jurisdictions, these CAs are consolidated with authorities responsible for prudential supervision of firms or with Financial Intelligence Units (FIUs).

6. A cross-sectoral analysis was performed using a combination of data analytics software, specifically in regard to quantitative data. In a preliminary stage, data cleaning tasks took place to guarantee accurate results and prepare data for further analysis: this included purging duplicated data, anomalous data, and other inconsistencies identified. When required, the incoherencies were clarified directly with the respective CAs for harmonisation. In a second step, the quantitative data was then analysed resorting to descriptive analytics techniques.

7. Nevertheless, the attainment of comparable data across the EU remains a challenging task. Despite a better common understanding of how the risk-based approach to AML/CFT should be applied and an increased convergence in supervisory practices across the EU, CAs continue to have different supervisory frameworks and organisational structures. While the EBA has worked to harmonise the collection and provision of data where possible, data obtained for the purposes of this report may, as a result, not always be comparable. EBA's conclusions are thus based on a combination of qualitative and quantitative assessments.

8. In addition to the data gathered through the questionnaire addressed to CAs, the EBA relied on subject-specific expert reports that were considered as needed and relevant to support the analysis of the information received from CAs. The EBA furthermore organised information-gathering exercises on specific topics. For instance, to gather information for its assessment of the ML/TF risks associated with de-risking, the EBA launched a 'Call for Input' to understand better why firms choose to de-risk instead of managing the risks associated with certain sectors or customers and to hear from segments of the financial sector and groups affected by de-risking.

9. Complementary to this report, the EBA has developed an interactive tool that gives a quick snapshot of the ML/TF risks covered in the report. The interactive tool is available on the EBA's website.[1] The tool was developed for data visualisation purposes only and is based entirely on the information contained in the report. It does not introduce any additional information.

3. Cross-sectoral money laundering and terrorist financing risks and new risks

10. In the Joint Opinion published in 2019[2] (the Joint Opinion 2019), the ESAs identified that some risks were cutting across a number of different sectors. In this report, the EBA has carried out an assessment of how these risks have since evolved. In addition, the EBA has identified new risks arising from specific contexts, such as those arising from the current COVID-19 pandemic.

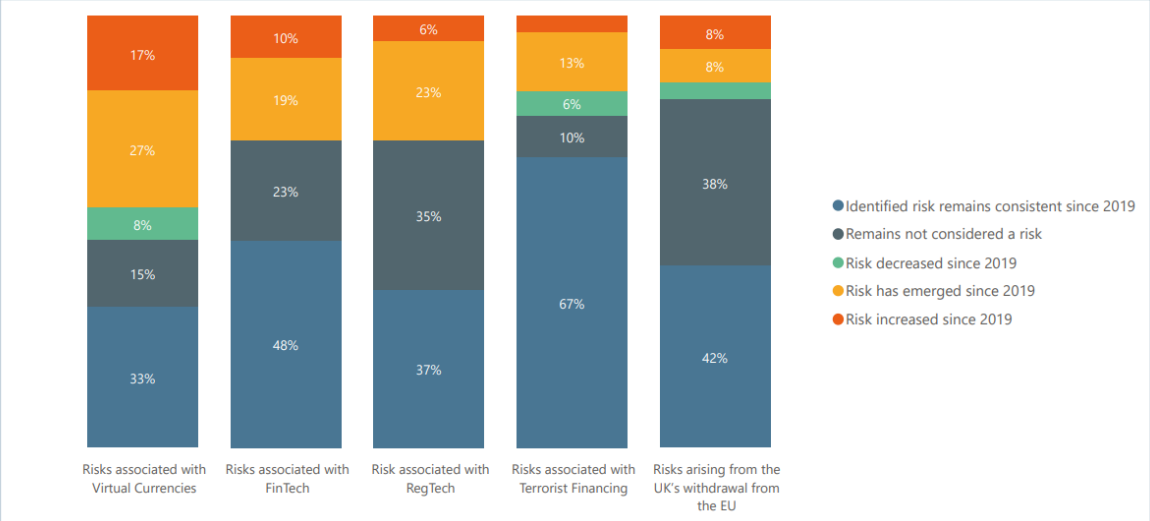
3.1 Evolution of cross-sectoral risks

11. In the Joint Opinion 2019, the ESAs identified that some risks were cutting across a number of different sectors. These include risks associated with virtual currencies (VCs), new technologies (FinTech and RegTech), terrorist financing (TF), ML/TF risks arising from the withdrawal of the United Kingdom (UK) from the EU and de-risking. Figure 1 depicts how these risks have been assessed since by CAs.

[1] Interactive tool on the Opinion on the risks of money laundering and terrorist financing affecting the European Union's financial sector, 2021.

[2] ESAs' Joint Opinion on the risks of money laundering and terrorist financing affecting the Union's financial sector, JC/2019/59.

Figure 1: Evolutions of risks compared to the risks identified in the Joint Opinion 2019



3.1.1 Risks associated with virtual currencies

12. In the Joint Opinion 2019, most CAs assessed virtual currencies[3] (VCs) as presenting significant emerging ML/TF risks. CAs pointed to risks relating to growing customer demand, the often-unregulated nature of associated products and services and associated lack of customer due diligence measures,[4] and a perception by CAs of limited overall understanding of ML/TF risks in the sector.

13. In their responses to the EBA's questionnaire, a number of CAs indicated that ML/TF risks from VCs have increased further since 2019 (see Figure 1). The key risk-increasing factor highlighted is the growth of the VC market, in terms of transactions processed and number of firms' clients that use VCs or are virtual asset service providers (VASP). CAs identified credit institutions, investment firms, electronic money issuers and payment institutions as the sectors that are most exposed to these risks, and in some cases suggested an increasing risk appetite from firms for VC-related business (albeit limited to date), notably in the context of the provision of financial services to VASPs. The most significant risk factor identified by CAs is the limited transparency of transactions and identities of end-customers involved in VC activities that in the context of several typologies may facilitate illegal activities such as fraud (i.e. forex or ICO-related investment scams), trading of illicit goods/services and terrorist financing.

14. The technology and business models deployed in the VC industry have evolved significantly over the last two years, and so have the efforts of national legislators to mitigate the risks arising from VCs. An important change in that regard is the inclusion of custodian wallet providers and providers engaged in exchange services between virtual and fiat currencies within the scope of

[3] Article 3(18) of AMLD4

[4] EBA report on crypto-assets, January 2019.

the AML/CFT legal framework by defining them as obliged entities in AMLD5. The related provisions now apply and should now have been transposed by all Member States in January 2020. However, not all MS have transposed these provisions yet.[5] Also important was the publication in September 2020 of the European Commission's proposal for a Regulation on Markets in Crypto-assets (MiCA) which, if adopted, will have the effect of expanding the EU regulatory perimeter to a wide range of crypto-asset activities, including in relation to stablecoins.[6] Further action is expected in 2021 with the publication of the EU's proposals to strengthen the EU's AML/CFT framework, including a proposal to align the scope of the AMLD with the activities covered by MiCA.

3.1.2 Risks associated with FinTech and RegTech

15. In the Joint Opinion 2019, CAs across all sectors identified ML/TF risks associated with FinTech, including its subset of RegTech solutions. Since then, the number of CAs that identify ML/TF risks associated with FinTech or RegTech activities has increased further. Risks associated with FinTech relate to new FinTech-related activities and solutions which may entail a number of AML/CFT risks, while risks associated with RegTech relate to the use of innovative technologies for regulatory compliance purposes.

16. The FinTech industry has expanded considerably since the Joint Opinion 2019 was published. In their responses to this year's EBA questionnaire, CAs identified credit institutions, investment firms, electronic money issuers and payment institutions as particularly vulnerable to the risks associated therewith. Risks identified by CAs included in particular the provision of unregulated financial products and services through Fintech firms that do not fall within the scope of AML/CFT legislation, or a perceived lack of understanding of FinTech firms' AML/CFT obligations.

17. As regards the types of risks associated with RegTech solutions, CAs highlighted ML/TF risks related to the perceived over-reliance of some firms on outsourcing arrangements without adequate oversight, including solutions that support AML/CFT solutions for transaction monitoring, customer screening, customer risk assessment and remote customer onboarding. These solutions pose a number of ML/TF risks, including identity fraud. Some CAs highlighted the need for firms to increase ML/TF risk awareness and perform appropriate risk analysis of the solutions they had adopted and developed, either in-house or purchased from third parties.

3.1.3 Terrorist financing

18. In the Joint Opinion 2019, ESAs considered the EU's financial sector to be exposed to increased levels of terrorist financing (TF) risk, pointing to persisting weaknesses in CFT systems and controls such as the focus of some firms' transaction monitoring on larger amounts, or common misconceptions equating TF risk to transactions involving listed persons caught by the sanctions regime.

[5] Anti-money laundering directive - transposition status (last updated in November 2020)

[6] Digital Finance package, September 2020.

19. The responses received through the EBA questionnaire indicate that for the large majority of CAs, the risks identified in 2019 remain constant and the observations set out in the Joint Opinion 2019 remain relevant. Some CAs identified an increased level of risk since 2019, mostly on the basis of updated National Risk Assessments or in view of emerging risks related, for instance, to VCs and crowdfunding platforms (see relevant sections). On the other hand, several CAs indicated they had not recently assessed risks associated with TF.

20. CAs identified current and emerging TF risks in almost all sectors, but the risks appear to be particularly relevant to credit institutions, payment institutions, bureaux de change, e-money institutions and credit providers (other than credit institutions). In the sector of credit institutions, some CAs pointed out firms' insufficient focus on TF risks, which can give rise to significant vulnerabilities, especially in some Member States where the phenomenon of radicalisation is more frequent and where there is a high number of foreign fighters and returnees, or where refugee flows include those originating from high-risk jurisdictions. Payment institutions, e-money institutions and bureaux de change are also perceived by several CAs as being particularly vulnerable to TF, in particular as regards the use of cash, pre-paid instruments, the importance of transactions from/to high-risk jurisdictions and the anonymity allowed from transactions below the CDD threshold. In the sector of credit providers, CAs highlighted that TF risks arise from consumer financing and the use of counterfeit identities or other frauds in loan application documents.

3.1.4 Risks arising from the withdrawal of the United Kingdom from the EU

21. In the Joint Opinion 2019, the ESAs identified ML/TF risks arising from the withdrawal of the United Kingdom (UK) from the EU. At the time, these risks were largely related to the relocation of financial institutions from the UK to Member States, the extent to which these institutions' AML/CFT systems and controls were adequate and compliant with the AML/CFT requirements of the receiving Member State, and the extent to which the receiving Member States' competent authorities were equipped to ensure effective AML/CFT oversight of those institutions.

22. Since 1 January 2021, the UK has been a 'third country' for AML/CFT purposes. An agreement on a new partnership that sets out the terms of the UK's trade with the EU was reached in December 2020, but it does not extend to the financial markets.

23. Since the Joint Opinion 2019, the risk perception of most CAs did not change significantly. Some CAs, especially those that have seen firms relocating in their jurisdictions, identified increased and emerging risks in the sectors of investment firms, credit institutions, payment institutions and e-money institutions. They highlighted concerns in relation to UK firms establishing themselves in the EU but continuing to operate mainly from the UK, thus making meaningful AML/CFT supervision more difficult.

24. A large number of CAs did not identify specific risks or suggested that the level of risk associated with the UK's withdrawal had reduced because the volume of firms relocating to their Member State from the UK had remained insignificant.

3.1.5 Risks arising from de-risking

25. De-risking refers to a decision taken by firms to refuse, or to terminate, business relationship with some categories of customers that they associate with higher ML/TF risk. Risks arising from de-risking were identified in both previous ESAs' Joint Opinions.[7] In particular, at the time, the ESAs were concerned that a lack of access to the financial system could potentially lead customers resorting to alternative payment channels in the EU and elsewhere. As a result, transactions may no longer be monitored, making the detection and reporting of suspicious transactions and, ultimately, the prevention of ML/TF more difficult.

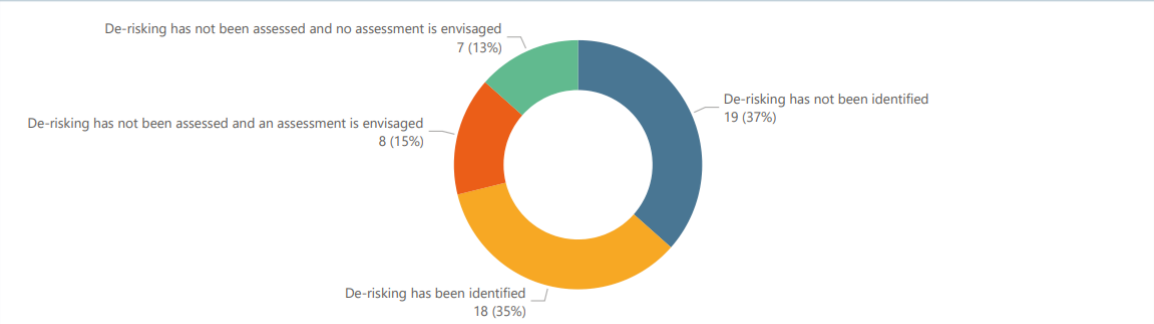
26. To establish the extent of de-risking within the EU, the EBA carried out two information gathering exercises. Firstly, the EBA gathered information from CAs as part of the questionnaire prepared for the purposes of this Opinion. Secondly, additional information was gathered from external stakeholders through a public 'Call for Input' to understand better why firms choose to de-risk instead of managing the risks associated with certain customers and to assess the scale and impact of de-risking by reaching out to customers affected by de-risking.[8] As part of the Call for Input, the EBA organised a virtual panel in September 2020 where it invited Not-for-Profit Organisations (NPOs), as one of the customer groups that is most impacted by de-risking, to share their experiences and concerns about de-risking practices in the EU. Overall, the EBA received responses from more than 300 respondents to its Call for Input. EBA has used information from these sources to inform this report.

27. As regards the responses received through the EBA's questionnaire, 18 CAs from 18 Member States, which are mostly responsible for the AML/CFT supervision of credit institutions, payment institutions and e-money institutions, indicated that they had identified de-risking practices in their jurisdiction. By contrast, 19 CAs from 15 Member States, most of which are responsible for the supervision of life insurance undertakings/life insurance intermediaries and bureaux de change, reported that they have not observed such practices in their Member State. 15 CAs from 13 Member States indicated they had not assessed whether de-risking was occurring in their jurisdiction; however, a half of those CAs indicated that such an assessment was envisaged, suggesting that the issue may become a concern in their jurisdictions.

[7] ESAs' Joint Opinion on the risks of money laundering and terrorist financing affecting the European Union's financial sector, JC/2017/07; ESAs' Joint Opinion on the risks of money laundering and terrorist financing affecting the European Union's financial sector, JC/2019/59

[8] EBA Call for Input on de-risking.

Figure 2: CAs' assessment of de-risking occurring in sectors under their supervision



28. Responses to the EBA's Call for Input suggest that firms, such as credit institutions, payment institutions and e-money institutions, which decide to de-risk certain groups of customers are influenced in their decision, from an AML/CFT perspective, by the following key factors:

- The increased level of geographical risk associated with the business relationships. Firms appear to be more likely to de-risk a customer that has links with jurisdictions that are exposed to high ML/TF risks. These links may include the customer or the ultimate beneficial owner being a citizen or a resident in those jurisdictions or the customer conducting its business operations there. Firms are particularly concerned about jurisdictions that have been identified by the European Commission as having strategic deficiencies in their AML/CFT regime in line with Article 9(2) of Directive (EU) 2015/849, jurisdictions identified by international organisations such as the FATF as presenting increased ML/TF risks, offshore jurisdictions, tax havens and jurisdictions associated with a higher incidence of corruption and other predicate offences. Types of customers that are most commonly de-risked on the basis of their exposure to increased geographical risk include asylum seekers and NPOs, particularly those who operate in or have their beneficiaries located in jurisdictions that are exposed to significant or very significant ML/TF risks.

- The level of risk associated with the nature of the customer. For example, customers such as PEPs or legal entities involving complex ownership structures that intend to make the identification of the ultimate beneficial owner more difficult and less transparent, may also be affected by de-risking.

- The increased level of risk associated with the customer business. Firms are more likely to de-risk corporate customers whose business involves processing significant volumes of cash transactions, or whose products allow for anonymity, such as anonymous pre-paid instruments or pre-paid instruments reloadable by cash or by crypto-currencies. Also, de-risking may affect those corporate customers that operate in sectors associated with a higher incidence of corruption and other predicate offences. Firms also indicated that corporate customers, which are obliged entities, may be affected by de-risking in situations where the firms consider the AML/CFT systems and controls put in place by

the customer to be ineffective. Customers most affected by this include firms that are payments institutions, e-money issuers, bureaux de change, real estate companies, where relevant, and regulated FinTech companies. Firms also refer in this context to virtual asset providers, where they fall within the remit of local AML/CFT legislation.

- The increased level of risk that may be linked to the correspondent banking relationships. In particular, correspondent banks, which are carrying out transactions for customers of the respondent bank but with whom they do not have a business relationship, may decide to terminate or reject the business relationship with the respondent bank if they have concerns that the respondent bank is exposed to significant or very significant ML/TF risks or has failed to implement effective AML/CFT systems and controls. Several respondent banks affected by de-risking indicated that to safeguard their correspondent relationships, they in turn decided to terminate business relationships with their own high-risk customers. In some cases, this has resulted in respondent banks shedding a significant part of their non-resident customers.

29. Many respondents affected by de-risking indicate that to be able to access financial services, they had to turn to alternative channels. These channels include informal funds transfer systems, the use of cash, or the use of financial services firms in other EU Member States or, in some cases, in non-EU countries. As regards the latter, several respondent banks in need of clearing services through the correspondent banking relationships report that they have sought, as an alternative, correspondent relationships with institutions located outside of the EU and therefore outside of the scope of EU supervision. The EBA thus considers that de-risking continues to pose important ML/TF risks.

30. Furthermore, evidence gathered from the Call for Input suggests that while concerns about ML/TF risks are an important driver of decisions to de-risk, other factors may also have a bearing on these decisions, such as a firm's profitability, reputation and operational costs. Several firms mentioned that a decision to de-risk some types of business may be based on the firms' concerns from a corporate social responsibility perspective. In particular, this affects businesses operating in certain sectors that present risks from an environmental, security or health perspective, such as the tobacco trade, the weapons industry, palm oil manufacturing and other sectors associated with deforestation as well as the coal industry.

31. In light of the above, it is evident that de-risking may have far-reaching implications on the de-risked customers' lives and their livelihoods. In some instances, these customers may even be prevented from exercising their right to a basic payment account provided in the Payment Account Directive.

3.2 Risks arising from legislative divergence and divergent supervisory practices

32. The Joint Opinion 2019 highlighted concerns about divergent national legal frameworks and divergent supervisory practices. These concerns remain valid and have become particularly acute concerning the regulation of crowdfunding platforms and the approaches taken to tackling market integrity risk associated with tax-related crimes.

3.2.1 Divergent supervisory practices

33. The Joint Opinion 2019 pointed to risk arising from national supervisory approaches and from gaps in the AML/CFT supervisory framework that, if exploited, could have significant implications for the robustness of the EU's AML/CFT defences and for the integrity and stability of the financial markets. Since the publication of the Joint Opinion 2019, the European Commission published its SNRA[9] as well as its assessment of alleged money laundering cases involving EU credit institutions, [10] pointing to persisting regulatory and supervisory fragmentation in relation to AML/CFT issues and the resulting threats to the integrity of the European Union's financial system. This assessment mirrors findings from the EBA's implementation reviews that suggested that ML/TF risk assessment processes and methodologies varied significantly in quality and scope, as did approaches to AML/CFT supervision and enforcement.[11] Consequently, in its response to the European Commission's Call for Advice on the future of the AML/CFT framework in the EU,[12] the EBA observed that there is currently no consistent approach by competent authorities to assessing and managing ML/TF risk, thus creating vulnerabilities in the EU's system of defence.

34. Similar to the exercise carried out in the Joint Opinion 2019, the EBA's questionnaire contained questions relating to CAs' approaches to AML/CFT supervision. The responses received from CAs suggest that challenges relating to the consistent application of a risk-based approach across the EU and the question of the adequacy of some CAs' approaches to AML/CFT supervision remain of significance. In particular:

- The number of specialist AML/CFT staff employed by CAs still varies significantly across the EU. While differences are expected and are acceptable under the risk-based approach, responses to the EBA's questionnaires and findings from international assessments suggest that the level of resources and AML/CFT supervision is not always commensurate with the level of ML/TF risk and the size of the sector in all Member States. Differences in the frequency and intensity of supervisory engagements with firms in different sectors can be

[9] Report from the Commission to the European Parliament and the Council on the assessment of the risk of money laundering and terrorist financing affecting the internal market and relating to cross-border activities, COM/2019/370 final.

[10] Report from the Commission to the European Parliament and the Council on the assessment of recent alleged money laundering cases involving EU credit institutions, COM/2019/373 final.

[11] EBA Report on competent authorities' approaches to the AML/CFT supervision of banks, EBA/Rep/2020/06.

[12] EBA report on the future AML/CFT framework in the EU, EBA/REP/2020/25.

linked to differing levels of risks in these sectors, but may instead be due to resource constraints at the level of CAs.

- Furthermore, in line with a risk-based approach, CAs are required to focus in particular on sectors they consider to present significant ML/TF risks. According to the responses received from CAs, credit institutions were commonly identified by CAs as higher risk and received substantive attention from CAs; but in many cases, this increased focus meant that few or no resources were allocated to understanding the ML/TF risks in other sectors. This included sectors that CAs assessed as high risk.

35. Specifically, the review of the responses received from CAs shows that a significant number of CAs had based their risk assessment of sectors on an 'informed estimate', but they had not carried out a risk assessment in line with the EBA's 2016 Risk-based Supervision Guidelines. At the same time, responses suggested that even in cases where the CAs estimated that the ML/TF risk associated with a sector was increased, they did not always follow this up with a corresponding increase in the frequency and intensity of AML/CFT supervision. In the bureaux de change and e-money institutions sectors, a large proportion of CAs indicated that they had not performed an assessment of the quality of the controls put in place by firms in these sectors, thus raising questions on the basis of which CAs assessed the residual risk profile of these sectors. As already pointed out in the Joint Opinion 2019, there is a risk that, in the absence of risk assessments and inspections, CAs may fail to identify, and act upon, ML/TF risks to which their sector is exposed.

3.2.2 Crowdfunding platforms

36. In line with Regulation (EU) 2020/1503 [13] (the Crowdfunding Regulation), 'crowdfunding platform' (CFP) refers to a publicly accessible internet-based information system operated or managed by a 'crowdfunding service provider' (CSP), which refers to a legal person that provides this service.

37. The type of fundraising activity carried out by CSPs through CFPs varies greatly depending on the crowdfunding model and includes investment, lending, and donations.[14] As a result, not all models of CFPs carry the same ML/TF risks. For instance, CSPs that collect funds for later onward transmission are particularly vulnerable to money laundering, including business models where the funds are collected for an undetermined project and consequently held in the investor's account until the project is determined. Donation platforms can also be misused to disguise the illicit origin of funds or for TF purposes. All these risks are now well documented in the European Commission's supranational risk assessment.[15]

[13] Article 2(1) of the Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business.

[14] For more details on the categories of crowdfunding platforms, see the annex of the Supranational Risk Assessment of the European Commission of ML/TF risks affecting the Union.

[15] See the annex of the Supranational Risk Assessment of the European Commission of ML/TF risks affecting the European Union. See also: Consultation paper for the EBA's risk factors guidelines; ESMA questions and answers on investment-based crowdfunding.

38. In their responses to the EBA's questionnaire, CAs detailed some of the ways CFPs could be abused for ML/TF purposes. For example, investment-based CFPs are vulnerable to being abused for ML purposes because of the collusion between the project owner and investor. In such situations, the investor may use illegally obtained funds to fund the investment project, for which the project owner has set an unrealistic funding target with an aim that the target will never be met. When, as planned, the project fails to meet the target, clean funds are returned to the investor. CFPs are also exposed to scam fundraising and CAs note that this risk is increased because it is relatively easy to launch and market a crowdfunding project, for example, by launching a social media campaign. CAs also drew a correlation between fictitious investment projects and the lack of knowledge by CSPs of the purposes of funding. Some other examples provided by CAs included situations where individuals are asked to donate amounts for a seemingly lawful charitable project, such as humanitarian initiatives, which are thereafter used for terrorist financing purposes. It may also involve launching a project that aims to support associations with potential links to terrorist organisations or activities.

39. CAs furthermore noted that CFPs present a higher risk of misuse for ML/TF purposes when they fall outside the scope of the AMLD and are not required to set up any measures to monitor and detect possible suspicious transactions. CFPs as such are not obliged entities under the AMLD, and while some Member States have included CFPs in their national legislation transposing the AMLD, not all Member States consider CFPs as obliged entities. By way of illustration, as part of the responses received to the EBA's questionnaire, among the 26 CAs that indicated they had CFPs operating in their jurisdictions, 12 CAs from 10 Member States considered a total of 263 CFPs as obliged entities, whereas 14 CAs from 12 Member States considered none of them as obliged entities.

40. In this regard, CAs noted that legislative divergence in this area is a major source of concern, and the absence of a harmonised legal framework setting out clear AML/CFT obligations applicable to the CSPs and CFPs significantly increases the EU's exposure to ML/TF risks. In the current framework, when CFPs are not considered obliged entities under the AMLD, the CSPs using the CFPs may be supervised for AML/CFT purposes when they provide services that are regulated under other legal instruments. For instance, some CSPs are regulated under the Markets in Financial Instruments Directive (MiFID), in which case they are automatically subject to AML/CFT rules for the services they provide under MiFID, which may also include, for example, investment services provided for the purposes of crowdfunding. Some CSPs may fall within the Article 3 exemption of MiFID and, as such, are not allowed to hold client money. As a result, they may not be considered as obliged entities. Furthermore, while CFPs are not regulated by the PSD2, some of the CSPs may provide certain payment services and, as such, would require authorisation as a payment service provider due to the nature of the service provided (i.e. when accounts are held on behalf of the users of these platforms). In such instances, they would also fall within the remit of the AMLD. It is evident that the absence of a common legal framework setting out the AML/CFT obligations of CFPs and CSPs, which is applied consistently across the EU by CSPs and competent authorities, creates significant gaps in the EU's AML/CFT defences.

41. Moreover, those CAs that consider CFPs as obliged entities in their jurisdictions and therefore have included them in their risk-based supervision have raised concerns about the AML/CFT policies and internal controls implemented by the CSPs in respect of the CFPs. They are particularly concerned about the effectiveness of CSPs' policies and procedures for the identification and verification of customers and beneficial owners. These risks can be increased due to the borderless nature of CFPs. Many CFPs are not established or CSPs are not located in the territory in which they operate. Often, they provide their services from another Member States or third country, which hinders the supervision by CAs of these CSPs and CFPs. CFPs' customers[16] or project owners[17] also can be located anywhere in the world, including in high-risk jurisdictions. CAs are also concerned about the systems and controls put in place by the CSPs to monitor and detect suspicious transactions. The main shortcomings relate to the lack of understanding by the CSPs of sources of funds used to fund projects and the purpose of the funding projects. In this regard, the use of less transparent means of payments, such as anonymous electronic money or virtual currencies, may increase the ML/TF risk. CAs also point out the lack of awareness of ML/TF risks by CSPs.

42. Regulation (EU) 2020/1503 of 7 October 2020 (the Crowdfunding Regulation) lays down a harmonised regime for the provision of crowdfunding services that will replace existing regimes at the national and EU levels, including national law. While it recognises that CFPs can be exposed to ML/TF risks, the Regulation does not subject all CSPs to the requirements of the AMLD. Instead, it restricts the provision of payment services to CSPs that are also payment service providers and thus subject to the AMLD, and requires the European Commission to assess, within two years of the Regulation entering into force, whether CSPs should be obliged entities under the AMLD.

3.2.3 Tax-related crimes

43. Facilitating tax crimes or handling proceeds from tax crimes undermines the integrity of the EU's financial system. There have been a number of cases in recent years, for example related to dividend arbitrage schemes (cum-ex and cum-cum scandals) and the Panama or Paradise Papers, which have given rise to questions about the adequacy of firms' AML systems and controls as well as the wider internal governance arrangements in this regard.

44. In April 2020, on foot of a request from the European Parliament, the EBA published its report on competent authorities' approaches to tackling market integrity risk associated with dividend arbitrage schemes.[18] The report highlighted wide divergence across the EU in terms of what tax offences are considered tax crimes under national laws. This meant that some tax offences may be considered tax crimes in some Members States and not in others. In the Action Plan that

[16] Any prospective or actual investor or project owner to whom a crowdfunding service provider provides, or intends to provide, crowdfunding services.

[17] Any natural or legal person who seeks funding through a crowdfunding platform.

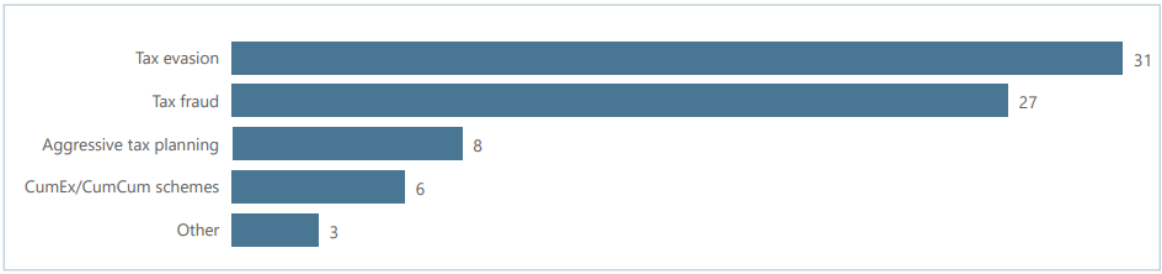
[18] EBA report on competent authorities' approaches to tackling market integrity risks associated with dividend arbitrage trading schemes, April 2020, EBA/REP/2020/15.

accompanied this report, the EBA committed to assess ML/TF risks associated with tax crimes in greater detail.[19]

45. In their responses to the EBAs' questionnaire prepared for the purpose of this report, CAs provided information regarding their consideration of tax crimes in ML/TF risk assessment of the financial sector and their co-operation with tax authorities. The responses suggest that there continues to be divergence in the approaches taken by CAs. While the majority of CAs stated that they have considered tax crimes as part of their ML/TF risk assessment, a significant number have not done so to date.

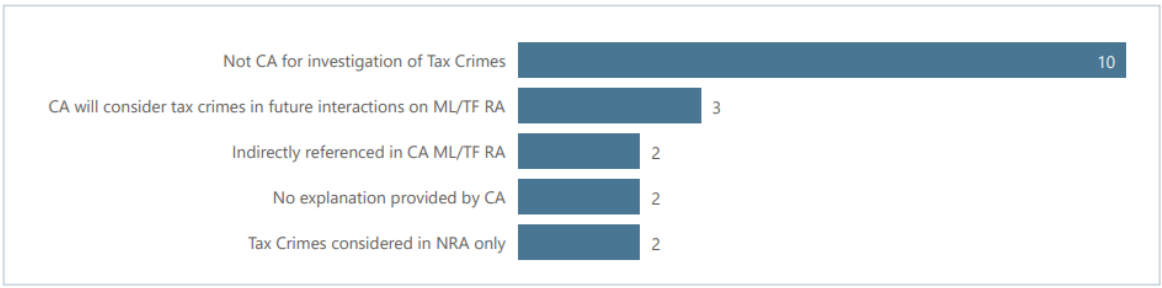
46. Of the CAs that already consider tax crimes as part of their ML/TF risk assessment, tax evasion and tax fraud are the most common types of tax crimes considered. Other tax crimes include payments from public treasury, including social security fraud, subsidies, and customs fraud.

Figure 3: Types of tax crime considered by CAs



47. Of the 19 CAs that stated that they have not done so, the majority indicate that they have not done so because they are not the authority designated as being legally competent for the investigation of tax crimes and as such, this is outside the scope of their mandate. Other reasons are set in the figure below.

Figure 4: Reasons CAs have not included tax crime in their ML/TF risk assessment



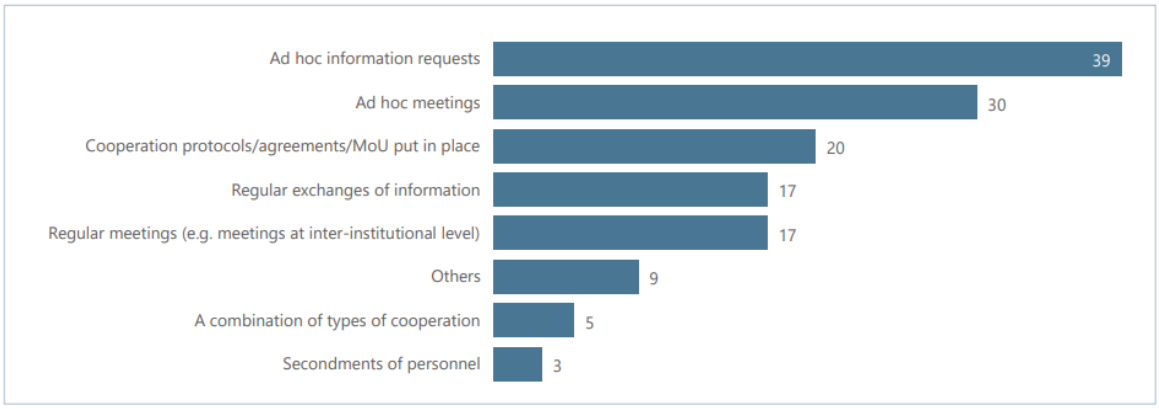
48. 47 out of 52 of the CAs that responded to the questionnaire advised that they co-operate with tax authorities in their Member State. Of the five CAs that indicated they had not done so, three

[19] EBA's action plan on dividend arbitrage trading schemes ('Cum-Ex/Cum-Cum'), April 2020.

advised that it is outside their AML/CFT supervisory mandate to do so and two have not so far identified the supervisory need to do so.

49. Those CAs that indicated they cooperate with tax authorities explained that the most common forms of co-operation were ad hoc information requests and ad hoc meetings. A number of CAs indicated they have put in place formal arrangements such as memorandum of understanding (MOUs) with the tax authorities to ensure regular cooperation and the exchange of information.

Figure 5: Methods used by CAs to co-operate with tax authorities



50. The types of information shared between CAs and tax authorities include:

- Specific case by case reporting of instances of suspected tax crimes
- Cooperation with tax authorities to draft typologies that might indicate tax crime
- Disclosures regarding transfers to offshore jurisdictions
- Freezing/unfreezing of bank accounts and safe custody boxes

3.3 Risks arising from the COVID-19 pandemic

51. In times of crisis such as the COVID-19 outbreak, maintaining effective systems and controls to ensure that the EU's financial system is not abused for ML/TF purposes is essential, both at the level of firms and for CAs supervising them, to safeguard the integrity of the EU's financial system.

52. In March 2020, the EBA issued a statement on actions to mitigate financial crime risks in the COVID-19 pandemic,[20] where it reminded CAs that financial crime remains unacceptable, even in times of crisis such as the COVID-19 outbreak. Subsequent to this statement, the EBA provided

[20] EBA statement on actions to mitigate financial crime risks in the COVID-19 pandemic, 31 March 2020

regular updates on the key risks associated with the pandemic through its newsletters and continued to liaise with CAs through its Standing Committee on ML/TF (the AMLSC). In particular, discussion rounds were organised on the impact of the pandemic on supervisory activities across the EU to facilitate the exchange of CAs' good practices to maintain their supervisory engagement at an adequate level.

53. As advised by Financial Intelligence Units (FIUs) and law enforcement authorities across the EU,[21] crime typologies related to the pandemic include frauds and scams related to the mis-selling of medical products, misuse of governmental and emergency funds, as well as multiple attempts by criminals to infiltrate the economy by taking advantage of the increased vulnerabilities of some socio-economic groups and small businesses affected by the crisis. Furthermore, evidence suggests that declining economic situations in some countries or sectors may result in firms changing their customer base, products and services or expanding in geographies that are associated with higher ML/TF risk, without necessarily being adequately equipped to manage these risks.

54. In their responses to the questionnaire that was circulated for the preparation of this report, 32 CAs out of the 52 indicated they have identified specific ML/TF risks related to the COVID-19 pandemic and, following the EBA's statement published in March 2020, the vast majority of CAs reported to the EBA they had taken steps to increase awareness in order to help firms under their supervision with the management of risk arising from COVID-19.

55. CAs noted that due to restrictions on movement, firms in most Member States moved to onboarding their customers remotely by using various online tools, including in situations where the use of remote onboarding tools had not previously been permitted or widely used. This meant that firms had to adapt quickly, without in some cases being sufficiently well equipped to mitigate resulting ML/TF risks effectively. CAs noted that in some cases, this had a negative impact on the quality of CDD measures that firms applied.

56. 14 CAs out of the 52 CAs recognised that the current pandemic may also have a negative impact on the firms' AML/CFT compliance. As a result of the reduction in revenues experienced during the pandemic, firms may be forced to cut costs. This in turn may result in firms reducing their staffing levels, including those responsible for AML/CFT compliance, or being unable to scale up their transaction monitoring systems quickly enough to integrate new crime typologies arising from the pandemic.

57. The COVID-19 pandemic may also affect the supervisory work of CAs, requiring CAs to make adjustments to their supervisory activities and plans, with many CAs conducting their supervisory activities remotely. Some CAs reported to the EBA that they have used innovative, online means to maintain an adequate level of AML/CFT supervision. These include virtual AML/CFT systems walk-throughs and virtual meetings with firms, as well as secure channels of communication to facilitate sample testing of customer files. While many CAs seem to have managed to adjust to the pandemic context and perhaps even learned new ways of conducting

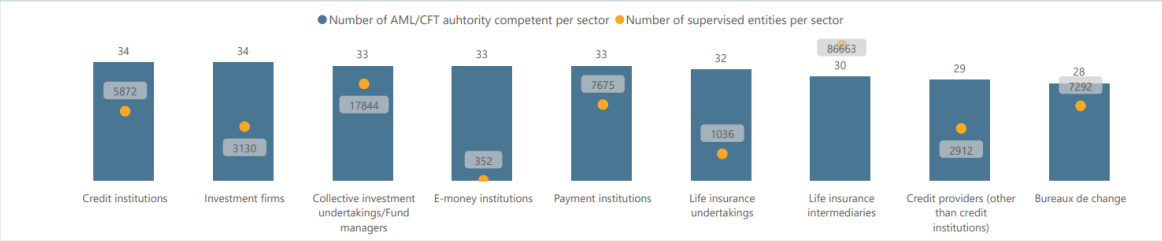
[21] Europol, How COVID-19-related crime infected Europe during 2020, November 2020

remote supervision, it should be underlined that on-site activities remain essential, when possible, to acquire a good understanding of firms' culture and governance.

4. Money laundering and terrorist financing risks specific to each sector

58. The EBA has assessed risks in each of the sectors under its remit. The number of CAs that responded to the EBA's questionnaire and the number of entities they have indicated to be under their supervision are provided in Figure 6.

Figure 6: Number of AML/CFT competent authorities per sector and number of entities under their supervision



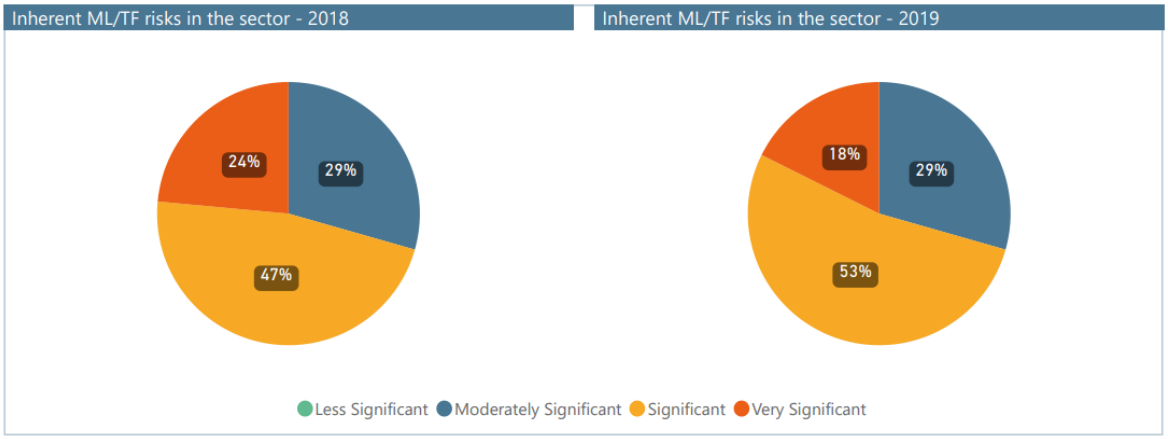
4.1 Credit institutions

59. In total, 34 CAs covering all CAs responsible for the supervision of the banking sector at EU level responded to the EBA's questionnaire in respect of data for both 2018 and 2019. Those CAs are responsible for the AML/CFT supervision of 5,872 credit institutions (CI).

4.1.1 Inherent risks

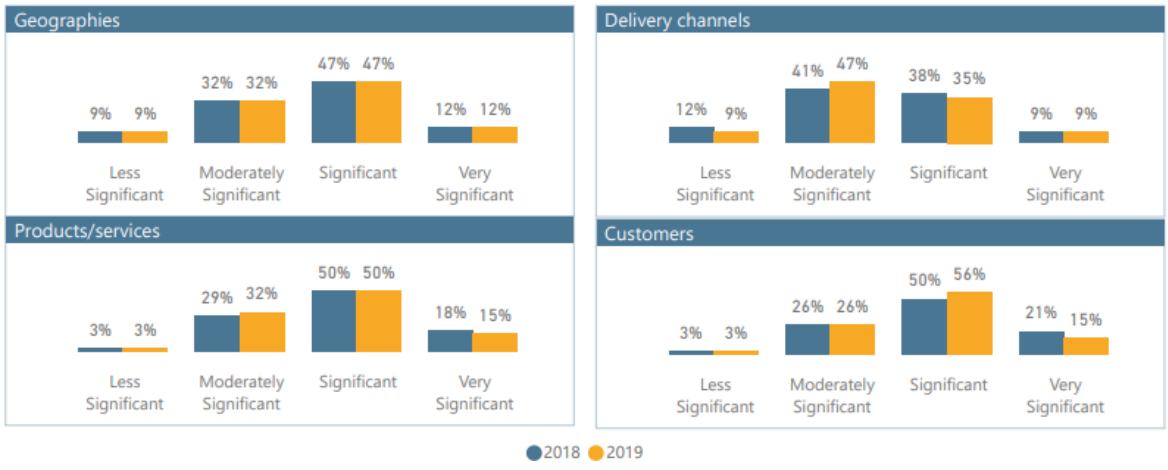
60. The majority of CAs considered the CIs sector as presenting a significant or very significant level of ML/TF inherent risks. This is an increase compared with the Joint Opinion 2019. This increase may be attributed to an intensification of supervisory activities in the sector, which may have resulted in CAs revising the risk profile upward.

Figure 7: Inherent ML/TF risks in the sector of credit institutions



61. CAs considered customers, products and services as the factors that present the higher level of inherent risk of ML/TF. Geographical risks have also been highlighted by those CAs supervising CIs that have a large proportion of non-resident customers, carry out large volumes of transactions with high-risk jurisdictions or have correspondent banking activities.

Figure 8: Inherent ML/TF risk factors in the sector of credit institutions



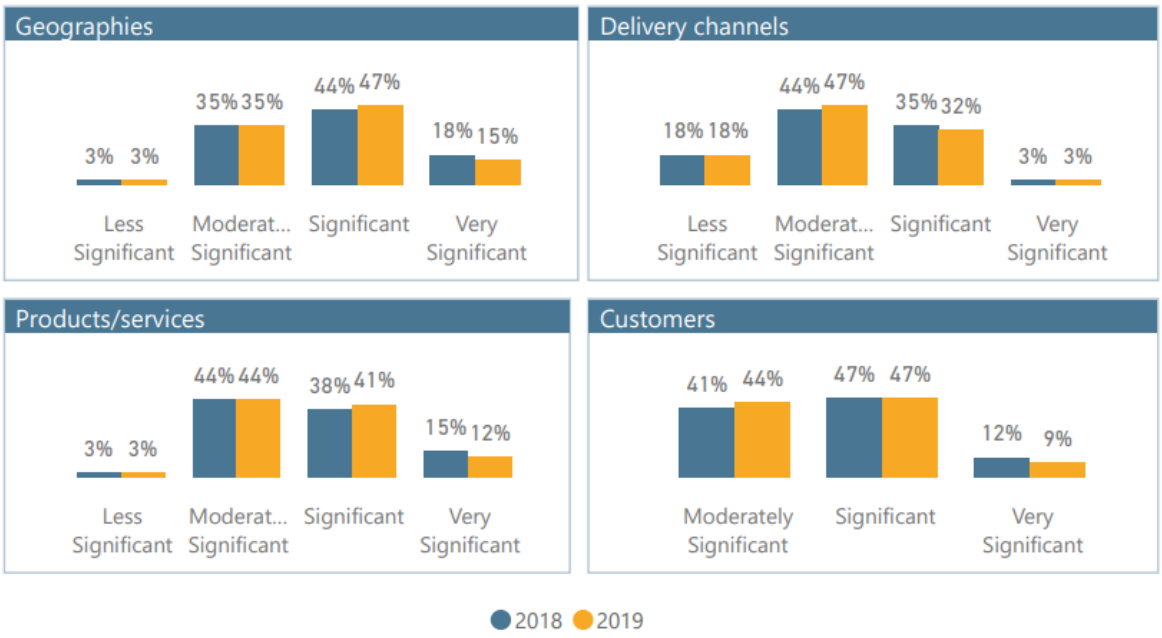
62. In the Joint Opinion 2019, the risk deriving from the use of cash was one of the key concerns for CAs, particularly as the sector is made up of many retail banks. However, the extent to which cash is used varies between Member States, and according to the responses provided in the EBA's questionnaire, the risk continues today to be relevant only for a much smaller proportion of CAs. Some CAs noted in that regard an increase in the use of contactless methods of payment, which has since been exacerbated in the current context of COVID-19.

63. CAs identified a number of current risks in the sector, in particular: the use of RegTech and concerns related to the quality of the outcomes of CDD process, in particular in relation to the identification of beneficial owners and in some cases, inadequate processes and controls to

identify PEPs; the increasing use of remote onboarding; IT risks. These concerns were reflected in the CAs' assessment of the quality of controls. Furthermore, several CAs indicated that they were concerned about the lack of understanding of TF risks in the sector; two CAs identified risks arising from tax-related crime and one CA identified risks associated with residency by investment schemes.

64. Risks associated with cross-border exposure also appeared to remain relevant for CAs from Member States that are known as international financial centres. Moreover, the possibility of regulatory arbitrage between Member States, due to the uneven application of EU regulation and the different approaches to AML/CFT supervision by national authorities, is of concern to several CAs.

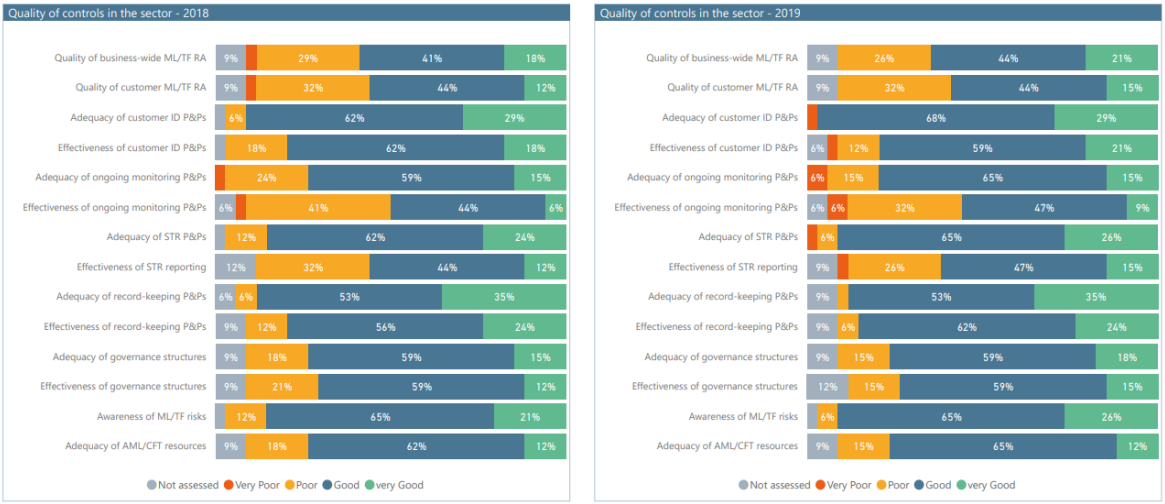
Figure 9: Cross-border ML/TF inherent risks in the sector of credit institutions



4.1.2 Quality of controls

65. The majority of CAs assessed the quality and adequacy of controls put in place by firms in the sector overall as good or very good. This is an improvement compared to the Joint Opinion 2019. However, there is still a sizeable proportion of CAs that considered that the quality of some controls has remained poor. In particular, several CAs indicated they were particularly concerned about the effectiveness of firms' transaction monitoring systems, deficiencies in the customer due diligence process, effectiveness of STR reporting and the quality of the customers' and business-wide risk assessments. These concerns were also reflected in the CAs' identification of key current risks in the sector.

Figure 10: Competent authorities' assessment of the quality of the controls in place in the sector of credit institutions



In this figure, 'RA' means a risk assessment and 'P&Ps' means policies and procedures.

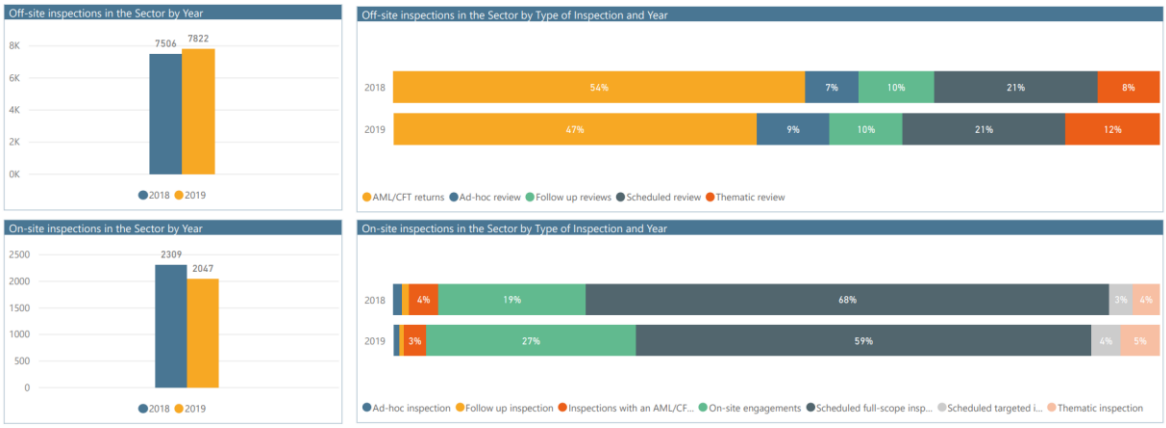
66. The main deficiencies identified in that regard are similar to those highlighted in the Joint Opinion 2019, suggesting that despite the supervision efforts provided by CAs and the improving trend in the adequacy and quality of overall controls, further improvement is still required. The EBA also notes that the sector's most well-rated controls are the adequacy of customer ID processes and policies and the awareness of ML/CFT risks.

67. Furthermore, the EBA notes that a small number of CAs (up to 12% in some cases as shown in Figure 10) indicated that they had not assessed the controls for this sector in both 2018 and 2019.

4.1.3 Supervisory activities

68. Compared with other sectors, the CIs sector is the one that receives the most important coverage in terms of supervisory activities. This is in line with the significance and complexity of the sector, its inherent exposure to ML/TF risk and its role of entry point to other financial services.

Figure 11: Off-site and on-site inspections in the sector of credit institutions



69. With regard to off-site activities, AML/CFT returns are the most preferred method, followed by scheduled off-site reviews. On-site activities focused mostly on full-scope scheduled inspections, followed by on-site engagements.[22] The vast majority of CIs across the EU have been subject to at least one type of on-site activity in the last two years.

70. Most of the on-site activities have been conducted in firms representing a moderately significant or less significant risk profile. There was a slight increasing trend identified in the number of inspections of firms with a significant and very significant risk profile.

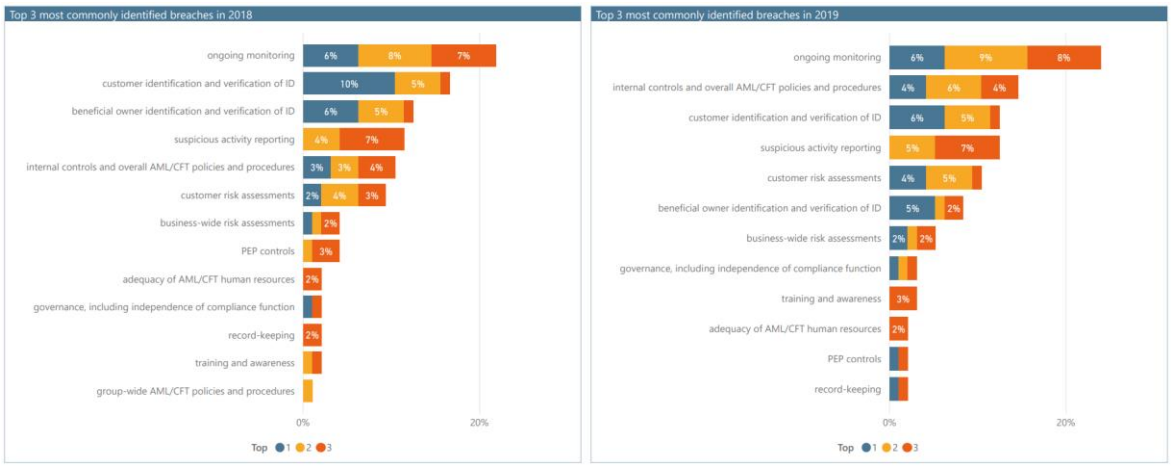
Figure 12: Supervisory engagements based on firms' risk level in the sector of credit institutions

[22] As per the definitions used in the EBA's questionnaire, on-site engagements mean other types of on-site engagements (i.e. different from full-scope, targeted, thematic or ad hoc inspections) with a firm or the firm's key personnel either at the premises of the firm or at the competent authority. These engagements are likely to include bilateral meetings with the firm's personnel, which are scheduled in line with the risk-based approach. Such engagement is not part of the other type of on-site inspection.

4.1.4 Breaches identified

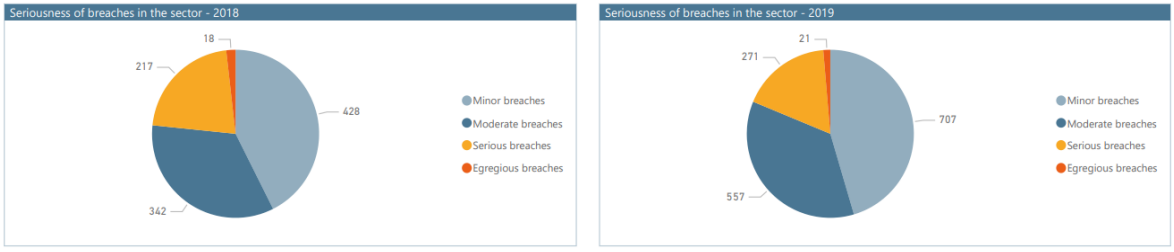
71. The most common breaches identified by CAs were related to customer due diligence; the effectiveness of transaction monitoring system and the subsequent filing of STRs and the management of ML/TF risks, including AML/CFT policies and procedures, internal controls and inadequate AML/CFT resources.

Figure 13: Most common breaches identified in the sector of credit institutions



72. The majority of breaches found in the sector were rated as moderate or minor in their seriousness by CAs. There was still a significant number of serious breaches that CAs found, likely to be concentrated in few banks. In comparison with the Joint Opinion 2019, there has been a considerable increase in the number of identified breaches overall, in line with increased levels of supervisory activity.

Figure 14: Seriousness of breaches identified in the sector of credit institutions



73. The most common follow-up by CAs consisted in orders to comply or implement measures in almost half of the cases, followed by fines and sanctions and the requests for the implementation of a remediation plan.

4.1.5 Overall risk profile

74. Half of all CAs assessed the sector as presenting a significant residual risk. This shows a little improvement in comparison to the CAs' assessment of the inherent risk, especially because more firms in the sector are now rated as presenting a less significant risk profile. This suggests that CAs consider that controls in place in some firms were effective in mitigating inherent risks.

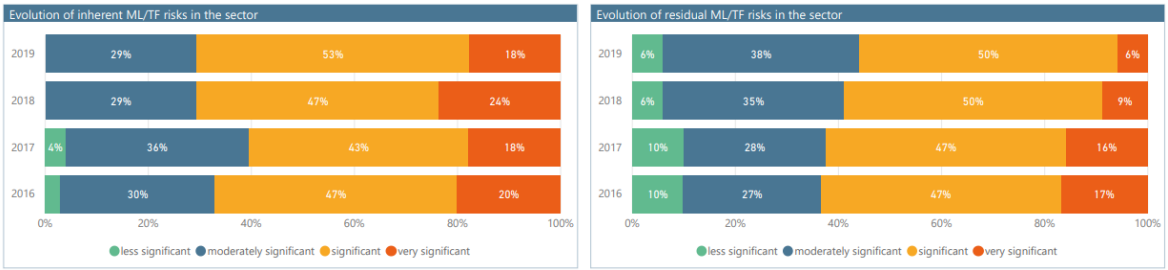
Figure 15: Overall ML/TF risk profile in the sector of credit institutions

75. The number of CAs that assessed the sector as presenting significant and very significant risk profiles remains significant and can be attributed to the concerns outlined above in key controls for the sector, but also to the fact that CAs may take into consideration the importance of the sector in the prevention of ML/TF.

76. Overall, the difference in assessment suggests either a difference in overall levels of risk exposure and quality of controls in banks across different Member States, or differences in CAs' approaches to the AML/CFT supervision of banks, or a combination of both.

77. Compared to the last Joint Opinion 2019, there seems to be a reduction of less and moderately significant inherent risk profiles, whereas when it comes to residual risks, these seem to be increasing.

Figure 16: Evolution of inherent and residual risks in the sector of credit institutions since 2016



4.1.6 Emerging risks

78. As in the Joint Opinion 2019, risks associated with FinTech were mentioned by many CAs as key risks, both current and emerging. CAs also indicated they were concerned by a perceived greater

risk appetite of some CIs for potentially riskier products and services. Some CAs referred to, for example, partnerships between CIs and FinTech companies offering digital payments through banking channels that could bear the risk, in their view, of operating as unregulated banks. Risks associated with virtual currencies were also mentioned by many CAs as key for the sector. Concerns were mentioned in particular as regards CIs servicing VASPs as customers, as detailed in section 3.1.1. above.

79. CAs further indicated in some instances that they were concerned that some firms may not be sufficiently well equipped to maintain the quality of their CDD procedures and concerns in light of an increase in the use of remote onboarding. CAs noted that this risk was exacerbated by the current COVID-19 pandemic, as detailed in section 3.3. above.

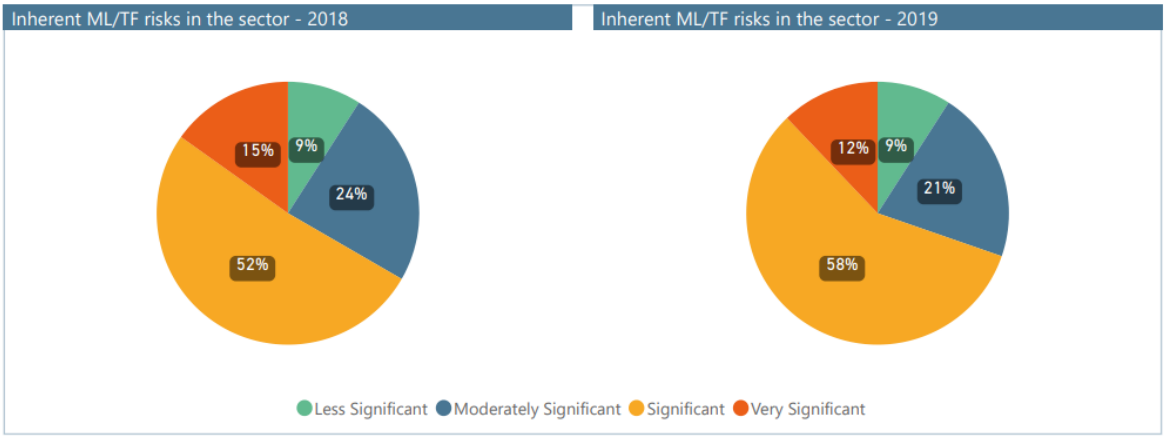
4.2 Payment institutions

80. In total, 33 CAs, which are responsible for the AML/CFT supervision of 7,675 obliged entities in the sector of payment institutions (PIs), including 4,499 agents from two Member States that consider agents as obliged entities in their own right, responded to the EBA's questionnaire in respect of data for both 2018 and 2019.

4.2.1 Inherent risks

81. CAs considered that the sector of PIs poses mostly significant or very significant inherent ML/TF risks. There is however a noticeable decrease since the Joint Opinion 2019 in the number of CAs that consider the sector to pose very significant risks (from 31% in 2017 to 12% in 2019).

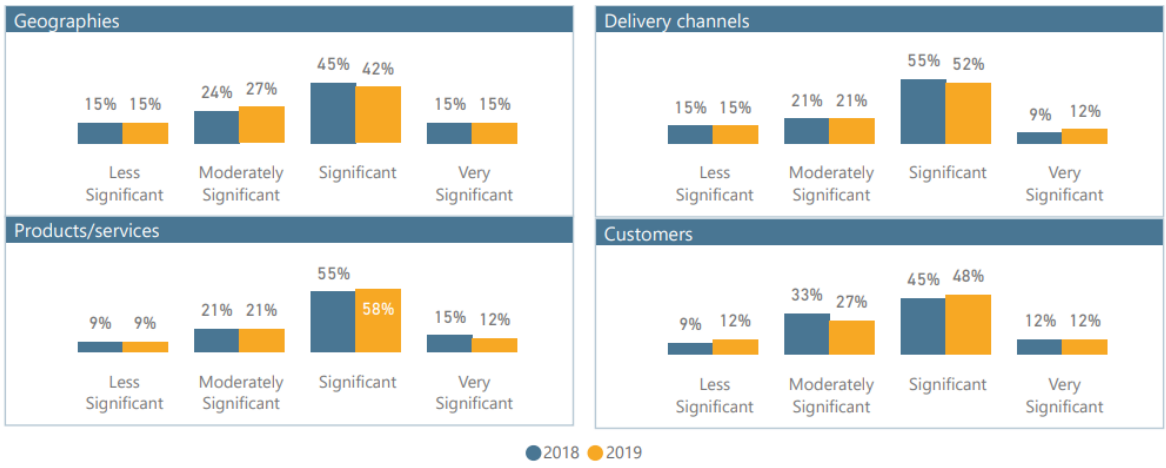
Figure 17: Inherent ML/TF risks in the sector of payment institutions



82. This assessment is mirrored in the ratings given by CAs to each risk factor, although products and services, on one hand, and geographies, on the other hand, represented a marginally higher

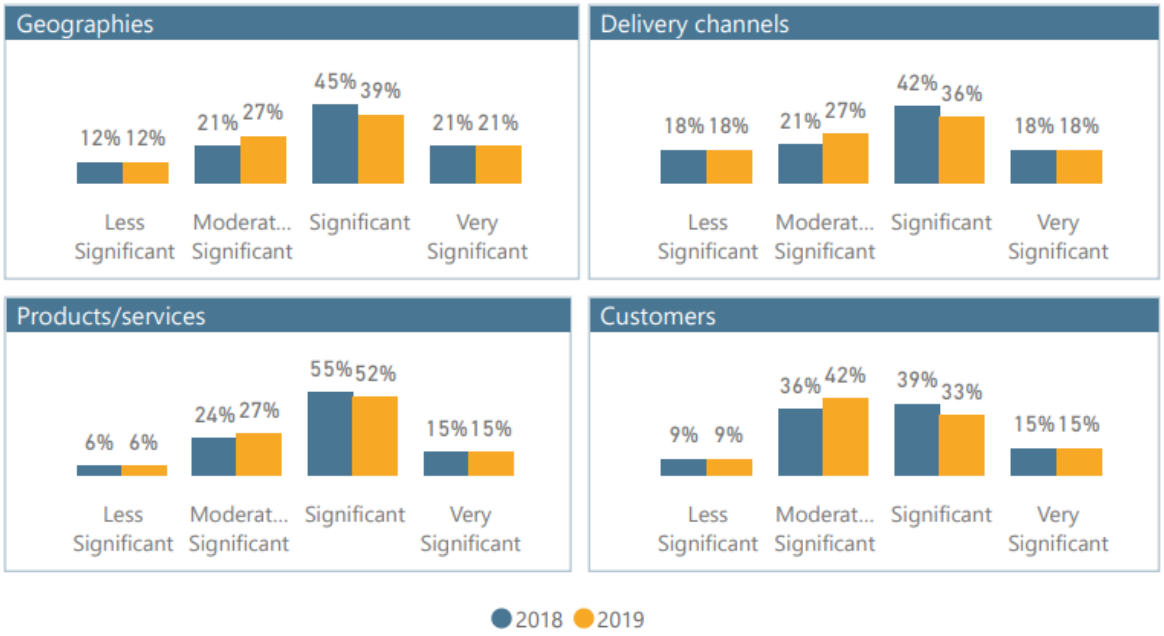
proportion of significant risk and very significant risk, respectively. This is similar to the Joint Opinion 2019.

Figure 18: Inherent ML/TF risk factors in the sector of payment institutions



83. The most common factors that increased the risk rating of this sector include the cash-intensive nature of the services offered, the prevalence of occasional transactions rather than established business relationships, the high-risk jurisdictions in which PIs operate, the large volume and high speed of transactions, the use of new technologies to facilitate the onboarding of customers remotely and the distribution channel used. Regarding the latter, CAs assessed the use of networks of agents in the sector as presenting particular risks, as this business model may result in a lack of adequate governance and proper oversight from the principal. All these factors are of special concern in the money remittance industry, which was also perceived by several CAs as particularly vulnerable to cross-border activities linked to terrorist financing. This concern is reflected in CAs' assessment of the sector's ML/TF risk exposure to cross-border transactions, where a significant proportion of CAs identified a number of significant and very significant risks in all the key risk factors.

Figure 19: Cross-border inherent ML/TF risks in the sector of payment institutions

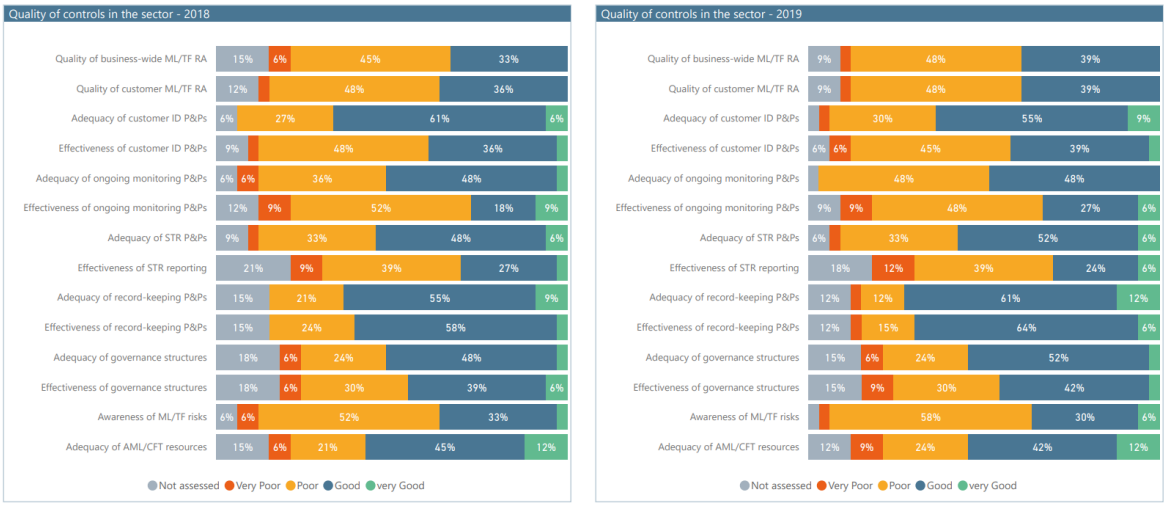


4.2.2 Quality of controls

84. A large proportion of CAs indicated that the data they provided for their assessment of the quality of controls put in place by firms was based on a formal risk assessment as envisaged in the EBA's risk-based supervision guidelines.

85. Overall, CAs' assessment of the quality of the controls put in place by firms in the sector suggests that these have improved compared to the Joint Opinion 2019, and there are a number of controls that were rated positively by a majority of CAs. The adequacy of customer ID policies and procedures, and the adequacy and effectiveness of record-keeping policies and procedures were the best rated in both years. However, many CAs considered that key controls for the sector remained poor or very poor. A significant number of CAs appeared to be concerned by the adequacy and effectiveness of ongoing monitoring policies and procedures, as well as the sector's awareness of ML/TF risks and the customer and business-wide risk assessments. STR reporting was also assessed as poor or very poor by a significant proportion of CAs and was the least assessed control in the sector.

Figure 20: Competent authorities' assessment of the quality of controls in place in the sector of payment institutions

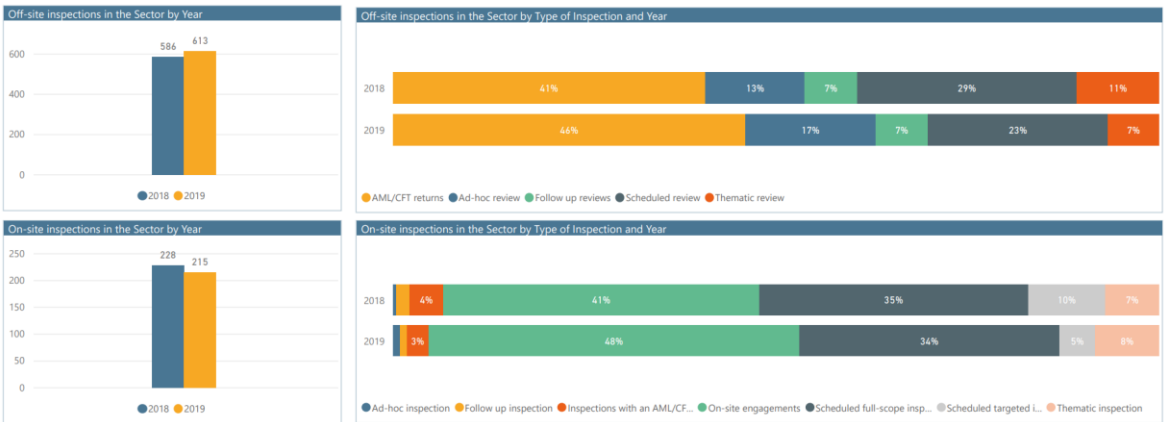


In this figure, 'RA' means a risk assessment and 'P&Ps' means policies and procedures.

4.2.3 Supervisory activities

86. Despite a significant risk profile and although almost all of the 33 CAs indicated they carried out some supervisory activity during 2018 and 2019, the sector saw a relatively poor level of supervisory activity in comparison with other sectors. Most of the activities were carried out off-site, mainly through AML/CFT returns and scheduled reviews. On-site activities, on the other hand, were mostly performed via on-site engagements that include bilateral meetings with the firm's personnel, but stopped short of more intrusive on-site inspections and scheduled full-scope inspections.

Figure 21: Off-site and on-site inspections in the sector of payment institutions



87. The information provided by CAs suggests that when inspections took place, they were broadly in line with the ML/TF risks presented by firms in the sector. Firms with a moderate or significant risk profile received the larger part of supervisory activities, both off-site and on-site.

Figure 22: Supervisory engagements based on firms' risk level in the sector of payment institutions

4.2.4 Breaches identified

88. CAs identified a relatively small number of breaches, with more breaches identified in 2019. The vast majority of breaches were considered minor or moderate in nature for both 2018 and 2019.

89. Most breaches in the sector related to internal controls and overall AML/CFT policies and procedures, ongoing monitoring, customer identification and verification of ID and STR reporting. This is broadly in line with the quality of controls that CAs were generally concerned about in the sector.

Figure 23: Most common breaches identified in the sector of payment institutions

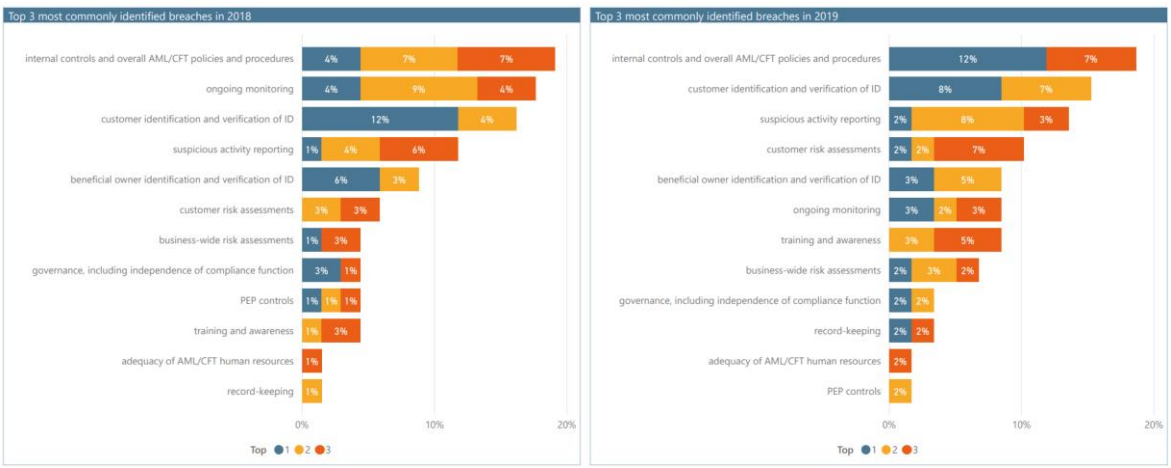
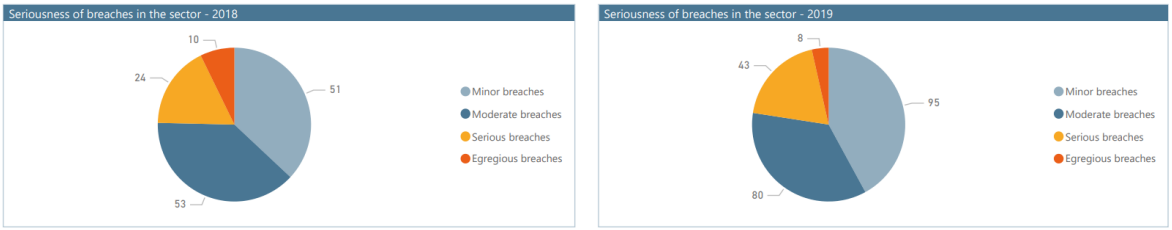


Figure 24: Seriousness of breaches identified in the sector of payment institutions

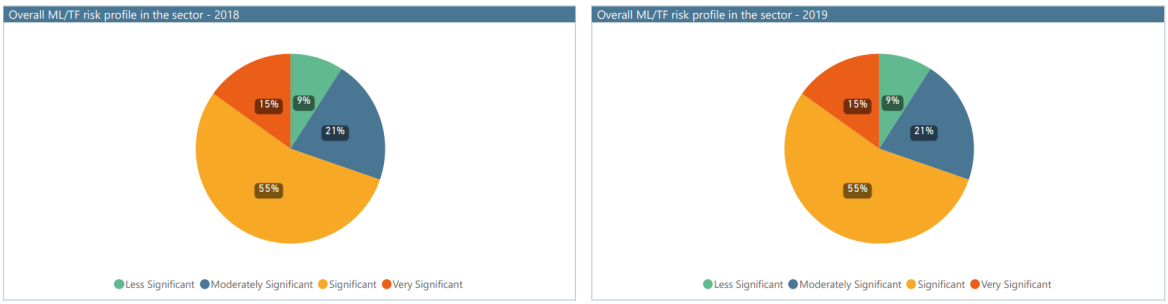


90. Feedback from CAs suggests that the most common supervisory measures used across CAs to mitigate weaknesses in firms' AML/CFT systems and controls included imposing a fine or administrative/pecuniary sanction, requiring the firm to put in place a remediation plan, implement measures or comply. However, in the few breaches identified as egregious, the CAs applied divergent approaches, from orders to put in place a remediation plan, cease and desist orders or withdrawal of a firm's authorisation or deregistration.

4.2.5 Overall risk profile of sector

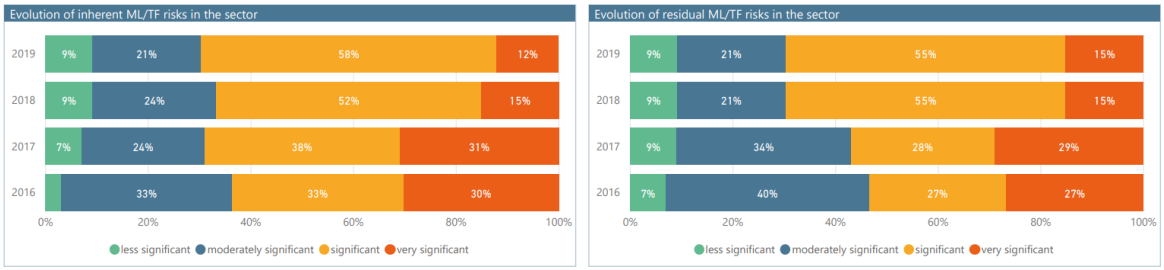
91. After considering inherent risks and controls, a large proportion of CAs viewed the overall ML/TF risk profile in the sector as significant or moderately significant. It appears that the overall risk rating is the same as the inherent risk rating, leading to the conclusion that, potentially, the controls in place were not sufficient to mitigate the overall risk in the sector.

Figure 25: Overall ML/TF risk profile in the sector of payment institutions



92. In comparison with the residual risk profile of the sector in the Joint Opinion 2019, the number of CAs that assessed the risk profile of firms in the sector as less significant and moderately significant has decreased. This may be attributed to the overall mixed assessment of the quality of key controls in the sector to mitigate inherent risks.

Figure 26: Evolution of inherent and residual ML/TF risks in the sector of payment institutions



4.2.6 Emerging risks

93. The use of new technologies and Fintech/Regtech solutions (for instance for the purpose of remote onboarding and digital identification), the use of virtual assets and/or onboarding of unregistered VASPs or virtual IBANs were among the key emerging risks identified by CAs. CAs also indicated they were concerned by the growing use of agents without an adequate governance and risk culture and without proper oversight.

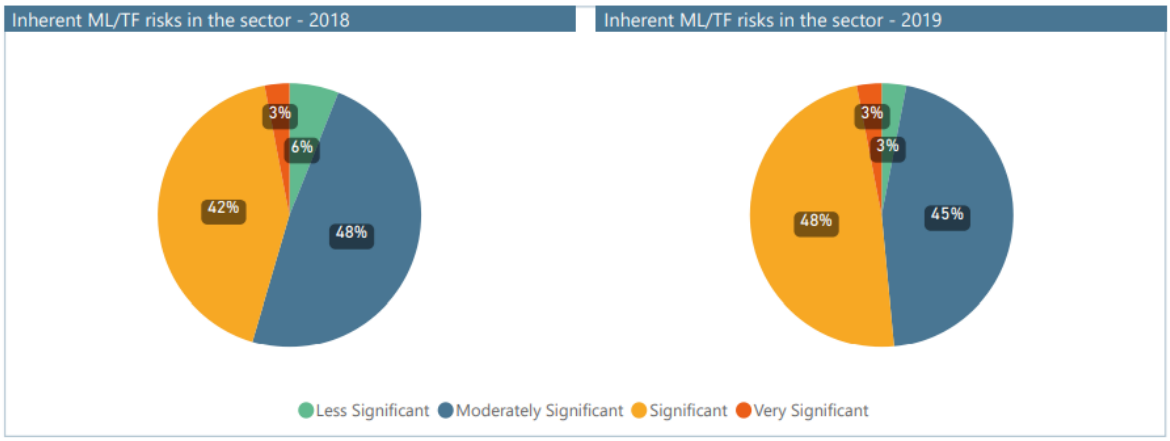
4.3 E-money institutions

94. In total, 33 CAs responsible for the supervision of e-money institutions (EMIs) responded to the EBAs' questionnaire. There are 352 supervised EMIs, including EMIs that provide services on a cross-border basis. This sector appears to be highly concentrated in the EU, with more than half of EMIs based in six Member States.

4.3.1 Inherent risks

95. The EMIs sector is considered to present significant or moderately significant risk from an ML/TF perspective by most CAs for both 2018 and 2019, with more CAs assessing the risk as significant in 2019 compared to 2018. However, compared to the Joint Opinion 2019, fewer CAs consider the sector as presenting very significant inherent ML/TF risks.

Figure 27: Inherent ML/TF risks in the sector of e-money institutions

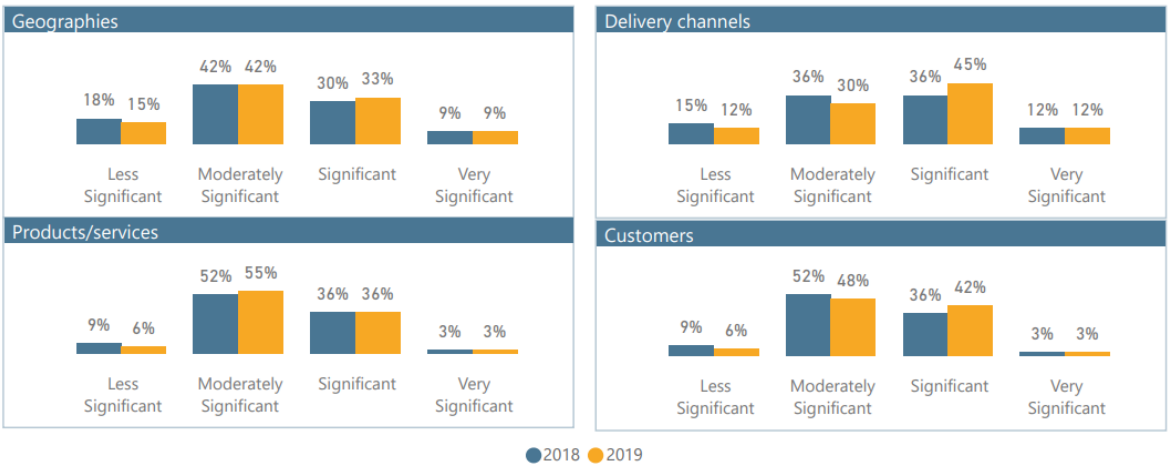


96. According to CAs, the main contributing factors that expose the sector to ML/TF risks are those associated with distribution channels. This is because the use of intermediaries in the distribution chain is common in the sector, which can make adequate AML/CFT controls and oversight more difficult.

97. Furthermore, CAs pointed to the sector's extensive reliance on non-face-to-face identification processes. Regtech solutions were identified by a number of CAs as key current risks, with increased risks of computer fraud and use of false documents. This, combined with other risk factors, such as the relative anonymity of the customer for some of the products benefitting from exemptions under the AMLD, the ease and speed of e-money transactions and the poor overall awareness of ML/TF risks, contributed to an increased risk profile. CAs also raised particular concerns about prepaid cards in situations where there was no limit to the number of cards a customer could own, which some CAs felt increased ML and TF risks. While prepaid cards are often of low value, the risk can be increased when the products offered by EMIs allow high-value or unlimited value payments, loading or redemption, including cash withdrawal. A related risk relates to close links of some EMIs with online gambling companies and other specific high-risk activities.

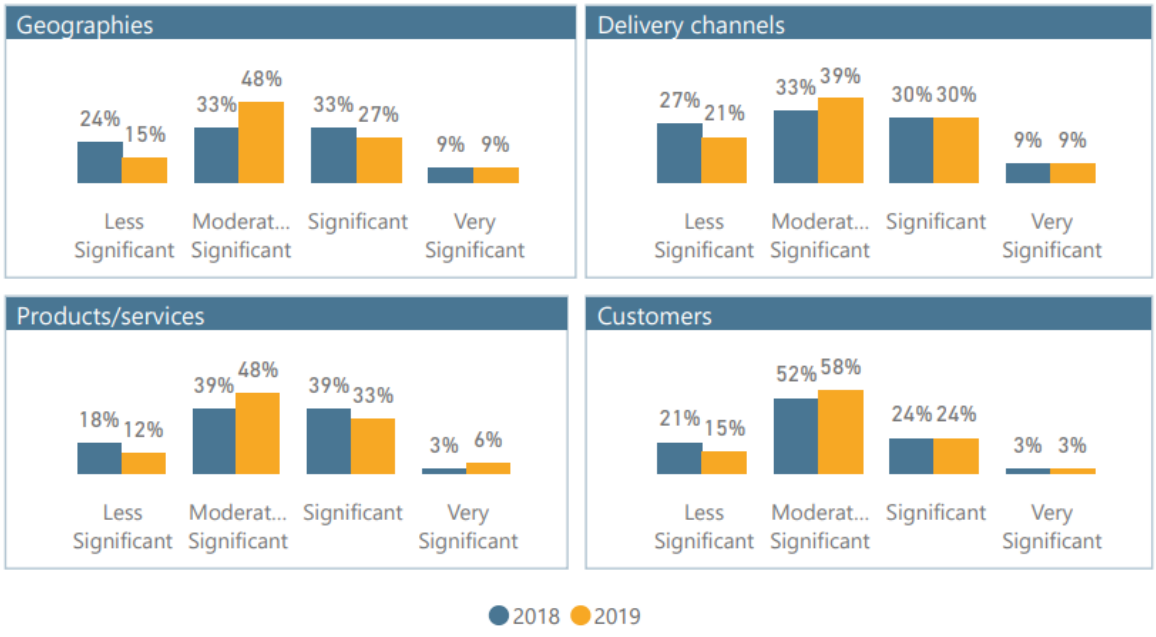
98. These concerns were reflected in how CAs assessed the inherent risk factors in the sector related to products, services, customers and geographies that were mostly considered as presenting either moderately significant or significant risks by most of the CAs.

Figure 28: Inherent ML/TF risk factors in the sector of e-money institutions



99. A large proportion of CAs assessed the sector's exposure to ML/TF risk associated with cross-border transactions as moderately significant or significant. Several CAs indicated that they were concerned about the quality of the AML/CFT rules and the risk of regulatory arbitrage, as well as specific risks posed by anonymous e-money issued in third countries which exceed national thresholds. However, it is noted that most CAs indicated they based this assessment on an informed estimate and not on a formal risk assessment.

Figure 29: Cross-border inherent ML/TF risks in the sector of e-money institutions



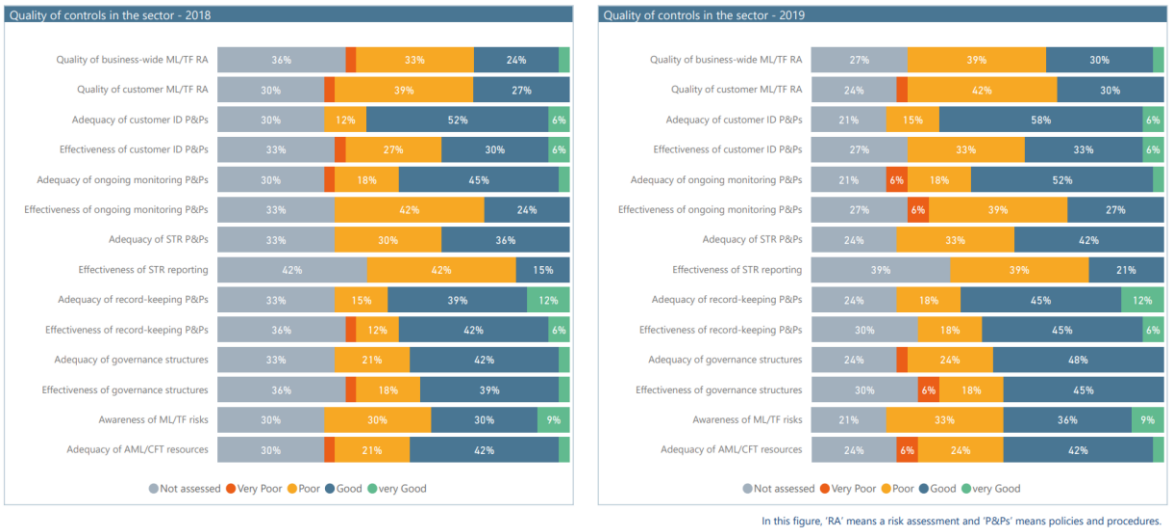
4.3.2 Quality of controls

100. A significant number of CAs indicated that the data they provided for their assessment of the quality of controls put in place by firms in the sector was based on an informed estimate of ML/TF risks, which predates a formal risk assessment such as the one envisaged in the EBA's Risk-based Supervision Guidelines.

101. A significant number of CAs indicated they had not carried out an assessment of controls in the sector. For those CAs that indicated that controls had been assessed, the rating of the quality of controls within the sector ranged from good to very poor, however compared to the Joint Opinion 2019, fewer CAs rated controls as very poor.

102. CAs appear to be most concerned about the effectiveness of ongoing monitoring policies and procedures and the effectiveness of STR reporting. They also raised concerns about the quality of EMIs' business-wide and customer ML/TF risk assessment. The EBA notes that the effectiveness of STR reporting remains one of the least assessed controls and this has not changed since the last Joint Opinion 2019. The adequacy of record-keeping policies and procedures and the adequacy of customer ID policies and procedures are the most well rated controls, also in line with the Joint Opinion 2019.

Figure 30: Competent authorities' assessment of the quality of the controls in place in the sector of e-money institutions



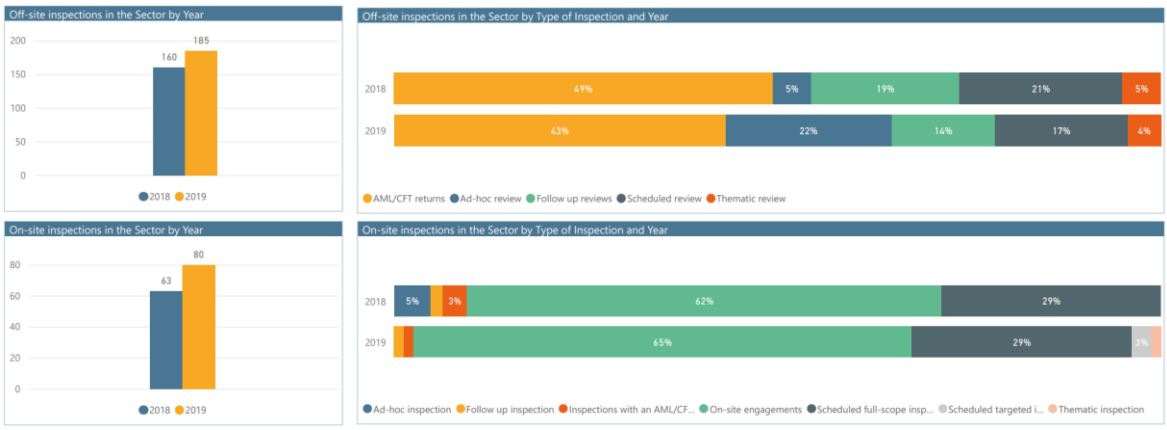
In this figure, 'RA' means a risk assessment and 'P&Ps' means policies and procedures.

4.3.3 Supervisory activities

103. In their supervision of the sector, CAs indicated they mostly relied on off-site supervisory activities, mainly through AML/CFT returns, but also off-site follow-up reviews, scheduled off-site reviews and ad hoc off-site reviews.

104. CAs relied less on on-site supervision of the sector. Where these took place, they consisted mostly of scheduled full-scope inspections and other type of on-site engagements.

Figure 31: Off-site and on-site inspections in the sector of e-money institutions



105. From the responses received, it appears that the inspections were concentrated on firms presenting a significant risk profile, followed by firms with a moderately significant risk profile. Between 2018 and 2019, the number of firms assessed as representing a significant risk increased while the number of less significant firms decreased.

Figure 32: Supervisory engagements based on firms' risk level in the sector of e-money institutions

4.3.4 Breaches identified

106. As a result of their supervisory activities, CAs identified a relatively small number of breaches. In 2018, where breaches were identified, these were mostly serious, with egregious breaches

identified in only few cases. In 2019, breaches identified were mostly minor or moderate, with no egregious breaches reported.

107. The most common breaches in the sector related to the customer and beneficial owner identification and verification of ID, internal controls and overall AML/CFT policies and procedures, ongoing monitoring, including transaction monitoring, and customer risk assessments. This is in line with the controls that CAs were generally concerned about.

Figure 33: Most common breaches identified in the sector of e-money institutions

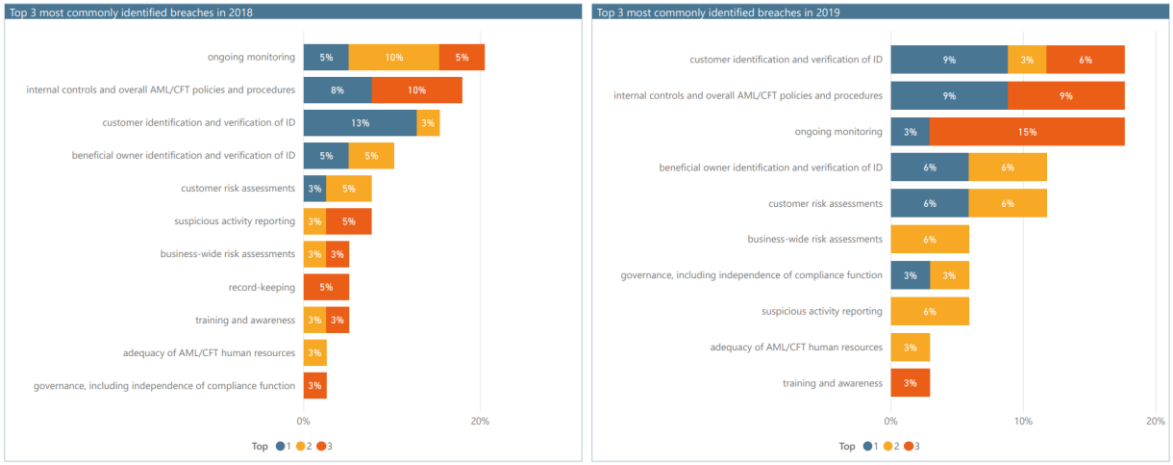
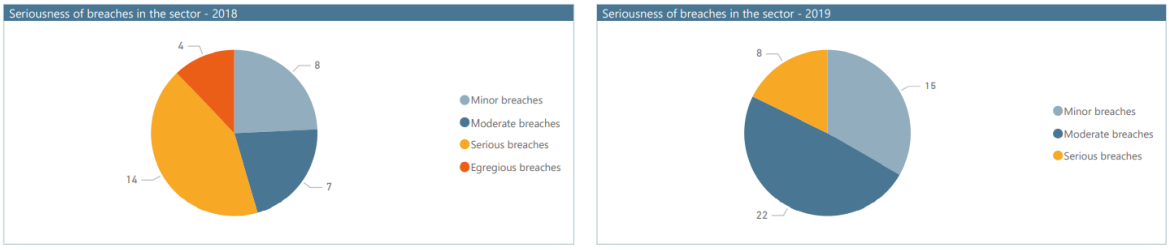


Figure 34: Seriousness of breaches identified in the sector of e-money institutions



108. Feedback from CAs points to divergent approaches by CAs in cases of identified egregious breaches. Some CAs, for instance, indicated they had issued orders to comply, orders to put in place a remediation plan and/or orders to implement mitigating measures, while other CAs applied restriction of business relationships with certain customers, fines/administrative pecuniary sanctions and temporary suspension (or resignation) of one or several member(s) of the management body (executive functions).

4.3.5 Overall risk profile

109. After considering the inherent risks in the sector and the quality of controls in place by firms, a significant part of CAs viewed the overall ML/TF risk profile in the sector as presenting

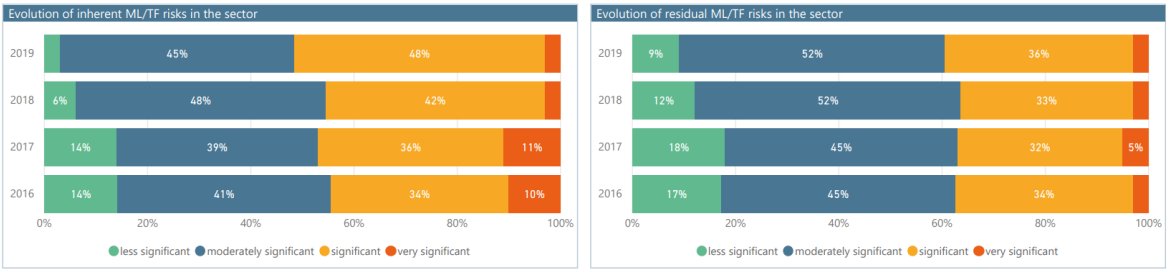
moderately significant or significant risk. This classification remains broadly the same in 2018 and 2019. It is worth mentioning that only a little over half of CAs indicated they had assessed the sector's residual risk based on formal assessments.

Figure 35: Overall ML/TF risk profile in the sector of e-money institutions

110. The overall risk rating shows only a slight improvement in comparison with the inherent risk rating, leading to the conclusion that, potentially, the controls in place were assessed as not sufficient to effectively mitigate the risks in the sector. Furthermore, the category of very significant residual risks remained broadly unchanged, which means that in CAs' views, more effective controls are still needed to mitigate the overall risk in the sector.

111. An overall assessment on the evolution of the inherent and residual risks since the Joint Opinion 2019 indicates that a larger number of CAs view the overall ML/TF risk profile in the sector as moderately significant or significant in recent years.

Figure 36: Evolution of inherent and residual ML/TF risks in the sector of e-money institutions since 2016



4.3.6 Emerging risks

112. Most CAs did not identify emerging risks in the sector that are different from current risks. However, like in other sectors, many CAs pointed out emerging risks in relation to loopholes in the legal/regulatory framework related to new technology-based products and services, including virtual currencies, as detailed in section 3.1.1. More EMIs are furthermore servicing

VASPs themselves. In addition, some CAs mentioned operational risks arising from the COVID-19 pandemic as concerns, as detailed in section 3.3. above.

113. In addition, CAs noted that the focus on compliance with sanctions remains critical, as it seems that criminals are increasingly using e-money to launder money and finance terrorism.

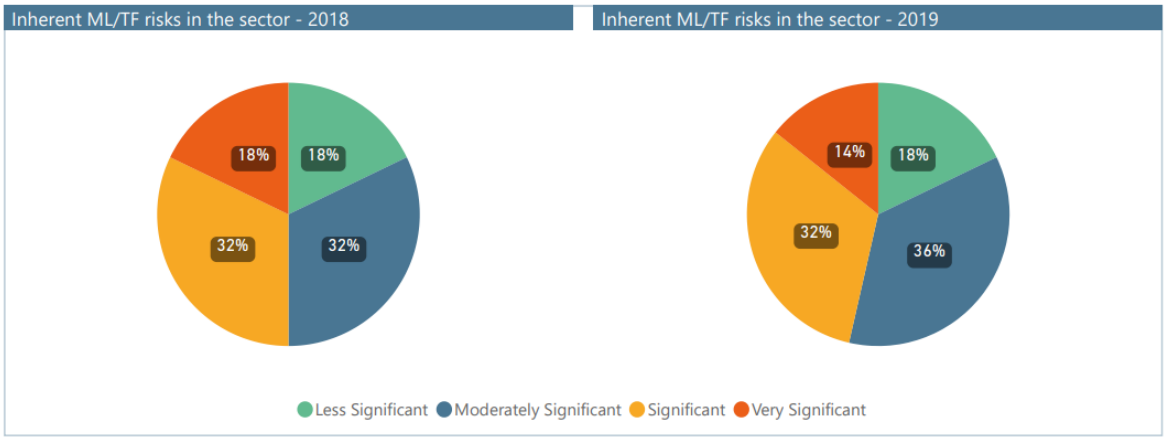
4.4 Bureaux de change

114. In total, 28 CAs that are responsible for the AML/CFT supervision of 7,292 firms providing currency exchange services (bureaux de change - BdC) responded to the EBA's questionnaire in respect of both 2018 and 2019. From the responses received, it is evident that the BdC sector is concentrated in Member States outside of the Eurozone, with 79% of the BdC based there.

4.4.1 Inherent risks

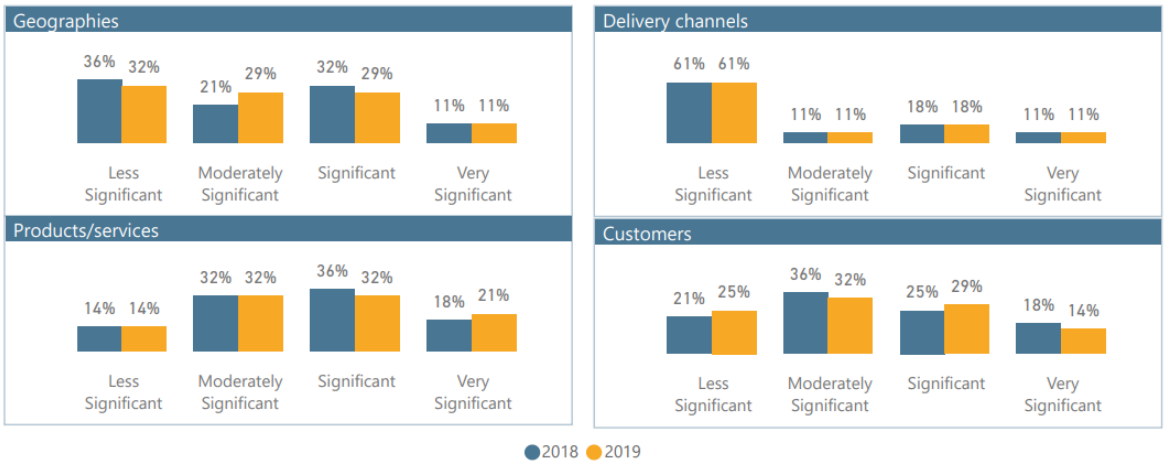
115. The BdC Sector is considered as presenting significant and very significant risks by around half of CAs from an inherent risk perspective, albeit with very different views on the risk profile by different Member States. In 2019, the trend in the inherent risk profile of the sector shifted slightly to be rated as mostly moderately significant or less significant by a majority of CAs.

Figure 37: Inherent ML/TF risk profile in the sector of bureaux de change



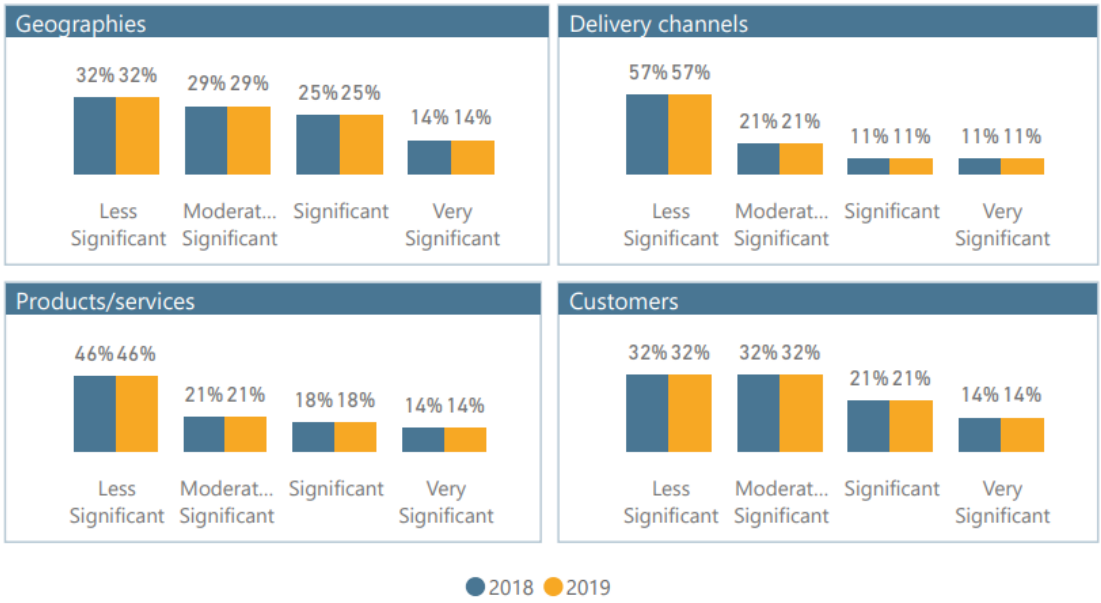
116. The key inherent risks in the sector mostly relate to the cash-intensive nature of the business and the nature of its customers that often include itinerant communities, for example immigrants, asylum seekers, cross-border workers, tourists. The significant number of occasional transactions in the sector, the non-application of CDD measures below certain occasional transactions thresholds and the significant volumes of walk-in customers create ML and TF opportunities.

Figure 38: Inherent ML/TF risk factors in the sector of bureaux de change



117. Regarding the sector's exposure to ML/TF risks, as a result of the variety of its customers, CAs highlighted geographical risk associated with the levels of activities occurring near border regions and associated cash-intensive operations as a key risk-increasing factor for the sector. In some cases, CAs identified specific risks for the sector related to predicate offences, such as smuggling.

Figure 39 : Cross-border inherent ML/TF risk factors for the sector of bureaux de change

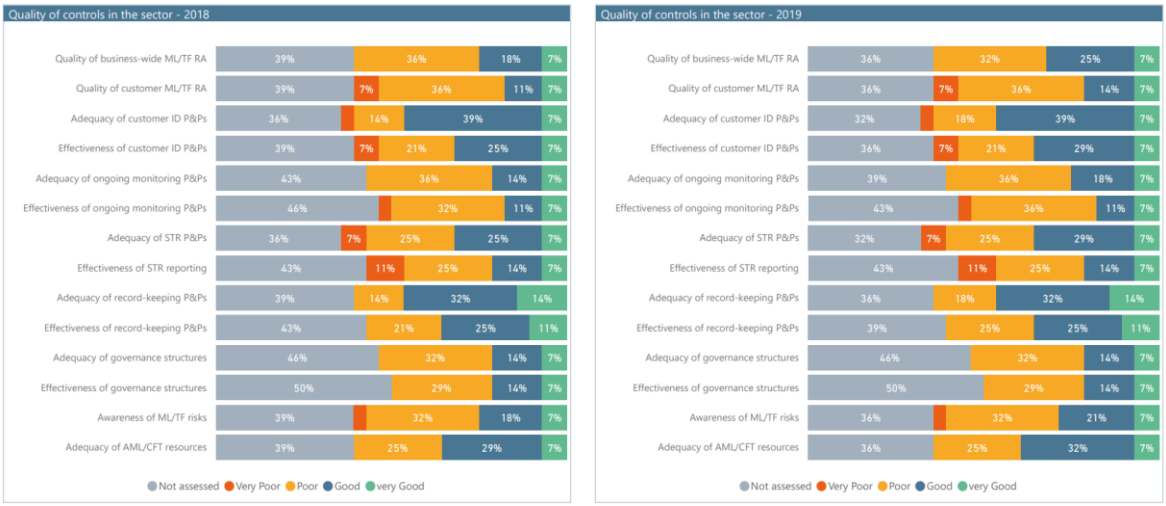


4.4.2 Quality of controls

118. Around half of CAs have indicated that the data they provided for their assessment of the quality of controls put in place by firms was based on an informed estimate of ML/TF risks, which predated a formal risk assessment as the one envisaged in the EBAs' Risk-based Supervision Guidelines. This sector stands out due to the high percentage of controls that CAs indicated they had not assessed, especially with regard to the adequacy and effectiveness of governance structures.

119. Most CAs that assessed the controls put in place by firms in the sector rated them as poor overall. Compared to the Joint Opinion 2019, the number of very poor assessments has decreased slightly, with more CAs now assessing controls as poor overall.

Figure 40: Competent authorities' assessment of quality of controls in place in the sector of bureau de change



120. CAs appeared to be mostly concerned about the quality of individual and business-wide risk assessments performed by firms and the effectiveness of CDD measures they take regarding customer identification, ongoing monitoring and reporting of suspicious transactions to FIU. Similar to the Joint Opinion 2019, the effectiveness of STR reporting was still considered very poor by a large proportion of CAs.

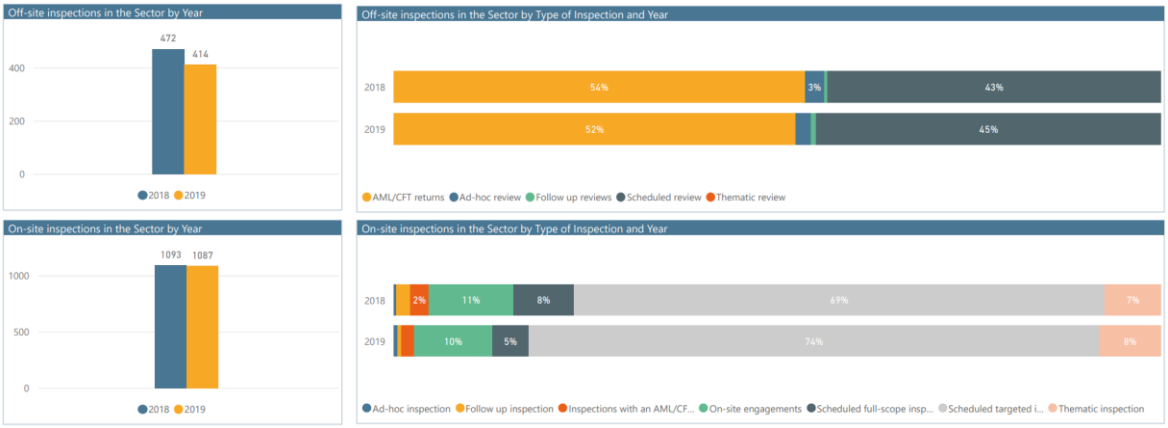
121. CAs furthermore expressed concerns about the governance structures and the resources allocated to AML/CFT function. Some CAs specified that these concerns were also related to risks associated with the business model of some firms in the sector. For instance, small firms are often run by sole proprietors with limited resources to have a sufficient level of ML/TF awareness.

4.4.3 Supervisory activities

122. The sector is subject, across the EU, to very divergent supervisory approaches among CAs. It is noticeable for instance that a large proportion of CAs indicated they had not performed a significant number of inspections with the sector, which was already apparent in the number of CAs that indicated they had not assessed the controls on the sector.

123. When inspections are carried out, CAs typically perform scheduled targeted on-site inspections, scheduled off-site reviews or receive AML returns. It appears that thematic on-site or off-site engagements or cooperation with prudential supervisors in respect of their assessment of governance arrangements are used less frequently by CAs when supervising this sector.

Figure 41: Off-site and on-site inspections carried out by competent authorities in the sector of bureaux de change



124. On-site inspections, when performed, appeared to be adequately concentrated on firms assessed as presenting significant or very significant risks.

Figure 42: Supervisory engagements based on firms' risk level in the sector of bureaux de change

4.4.4 Breaches identified

125. CAs have identified a relatively small number of breaches in the sector in 2018 and 2019, which were mainly rated as minor or moderate in their seriousness.

Figure 43: Most common breaches identified in the sector of bureaux de change

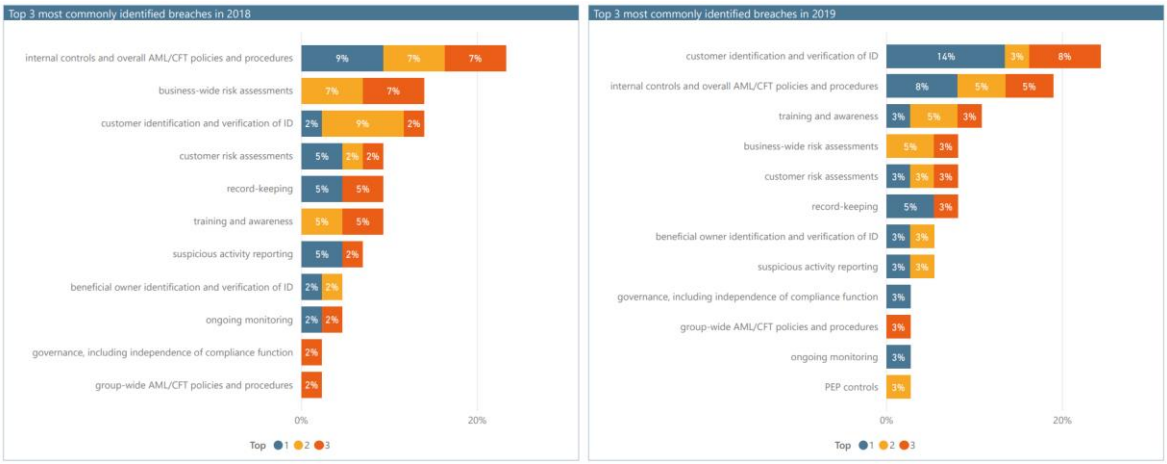
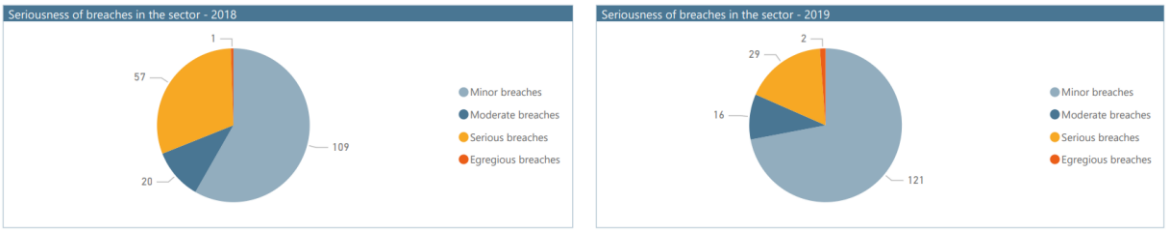


Figure 44: Seriousness of the breaches identified in the sector of bureaux de change



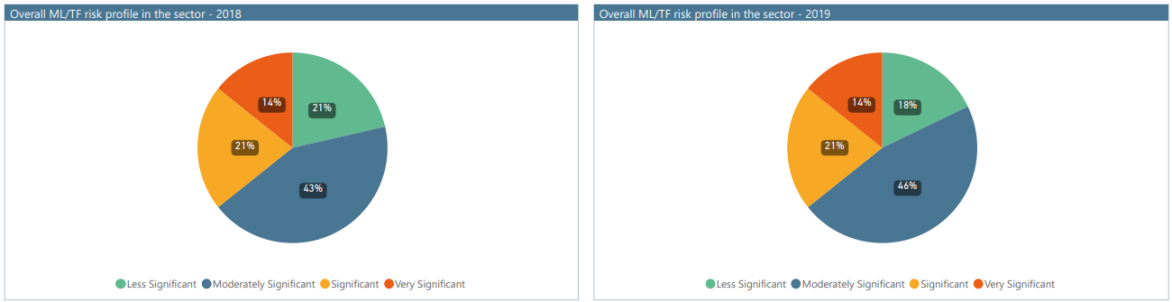
126. From the responses received, it appears that the main breaches in this sector largely correspond to the controls that CAs were generally concerned about, such as internal controls and overall AML/CFT policies and procedures, customer identification and verification of ID, business-wide risk assessment, training and awareness. On the other hand, breaches on suspicious activity reporting and ongoing monitoring were less frequent than what could be expected based on the assessment of controls. This suggests that the sector would benefit from further risk assessment or that the scope of supervisory actions could be better aligned with the risks identified.

127. Feedback from competent authorities suggests that minor breaches are usually followed by fines or administrative pecuniary sanctions. On moderate or serious breaches, the approaches followed appear to be more diverse. In these cases, CAs mostly applied additional measures such as orders to comply, warnings, reprimands and orders to implement measures or put in place a remediation plan. In isolated cases of serious breaches, they applied even more restrictive measures such as cease and desist orders, business suspension orders, in line with their sanctioning policies.

4.4.5 Overall risk profile

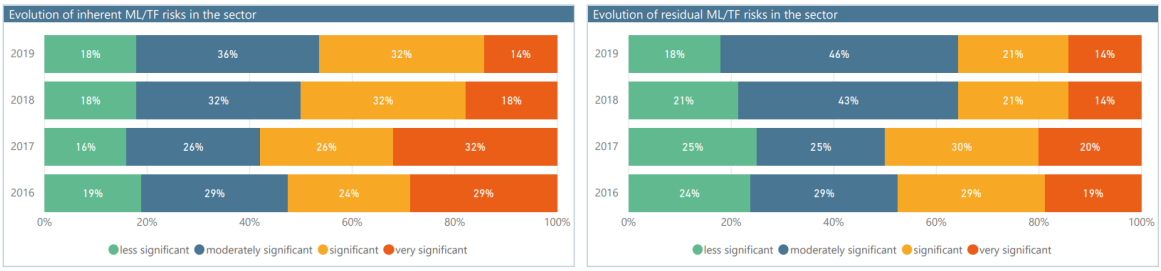
128. After considering inherent risks and controls, a significant part of CAs view the overall ML/TF risk profile in the sector as moderately significant. This classification remains broadly the same in 2018 and 2019.

Figure 45: Overall ML/TF risk profile for the sector of bureaux de change



129. The overall risk rating is broadly the same as the inherent risk rating. In few cases, CAs identified a mitigating effect from controls, on the basis of formal sectoral assessments and supervisory activities that appeared to address sufficiently their concerns on inherent risks.

Figure 46: Evolution of inherent and residual ML/TF risks since 2016



4.4.6 Emerging risks

130. Many CAs do not identified specific emerging risks in this sector. Instead, the cash-based nature of the sector's business and the sector's limited understanding of their AML/CFT obligations were referred by CAs as an ongoing source of concern.

131. However, as highlighted by some CAs, the COVID-19 pandemic appeared to have had an impact on the sector, as tourism and the use of cash in general have decreased in the current context. CAs noted in that regard that this could threaten the viability of the business model of some firms.

132. On a longer term, some CAs indicated that the demand for cash-based currency exchange services may decrease in the future, as the cost of cross-border payments becomes smaller in a growing and more competitive EU payment service market under PSD2 and Regulation (EE) 2019/518.

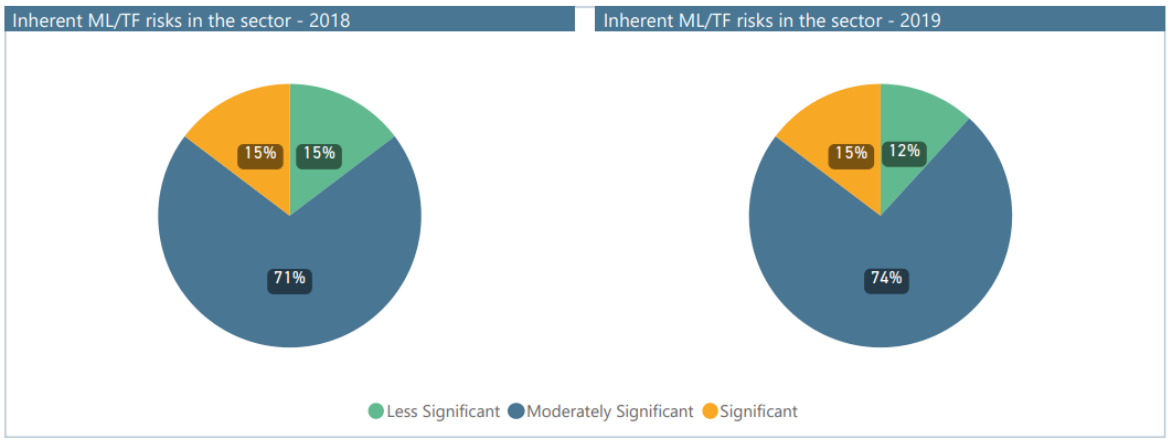
4.5 Investment firms

133. The EBA received responses from 34 CAs responsible for the AML/CFT supervision of investment firms for both years under review (2018 and 2019), covering a total of 3,130 investment firms under their supervision.

4.5.1 Inherent risks

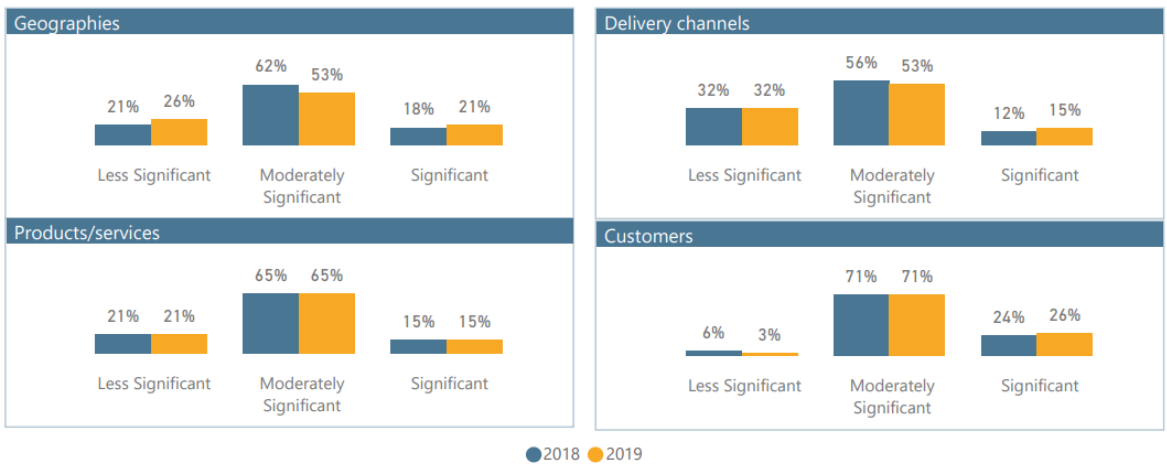
134. The majority of CAs have rated the overall inherent risk profile of the investment firms' sector as moderately significant. The sector's exposure to ML/TF risk has remained substantially unchanged since the Joint Opinion 2019, although a very slight decrease was observed in the number of CAs that assessed the sector as presenting significant ML/FT risk.

Figure 47: Inherent ML/TF risks in the sector of investment firms



135. The analysis of the individual risk factors shows that all categories of risks have been rated by most CAs as posing a moderately significant risk. This is similar to the Joint Opinion 2019. However, when compared with the Joint Opinion 2019, customer risk rating has increased to significant. Investment firms provide a great variety of services, for example the provision of investment advice, purchase or sale of financial products on an execution only basis, the provision of portfolio management allowing investment service providers discretion over the investments carried out, and dealing on own accounts. CAs expressed concerned related in particular to the extent to which firms' customers exposed firms to risks, both in terms of difficulties encountered in identifying and verifying customers' documentations and also in identifying the beneficial owners of complex corporate structures. The customer risk exposure appears to be further increased in view of the exposure to high net worth individuals and the difficulties that firms may encounter in understanding the source of wealth and source of funds of customers, including customers who require such services for the acquisition of residence rights and citizenship.

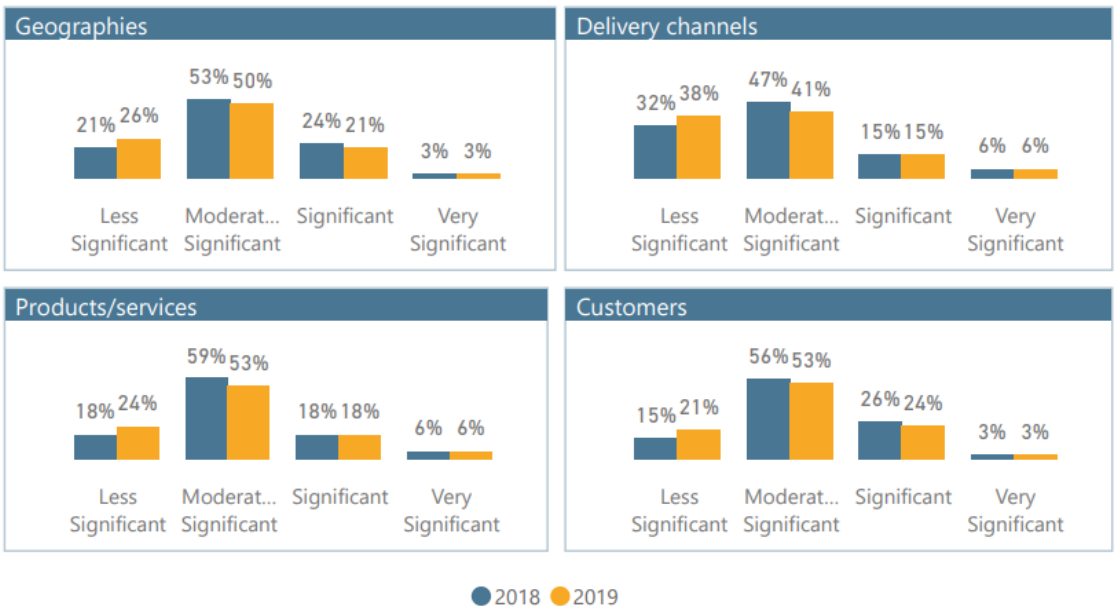
Figure 48: Inherent ML/TF risk factors in the sector of investment firms



136. Similarly, the significant geographical risk rating has also increased since the Joint Opinion 2019. Such increase in rating may be attributed to customer funds generated by activities in high-risk jurisdictions and/or funds transferred from financial institutions in high-risk jurisdictions. On the other hand, significant risk exposure from the products offered by investment firms has substantially decreased since the last Opinion. This could be the result of investment firms limiting the provision of higher risk services such as execution only and nominee services. It is however uncertain if this trend is related to ML/TF risk mitigation efforts.

137. Most of the CAs assessed this sector as having moderately significant inherent exposure to ML/FT risks arising from cross-border activities. The main concern lies in the delivery channels and products/services which have the highest percentage of very significant inherent risk ratings, although it remains low.

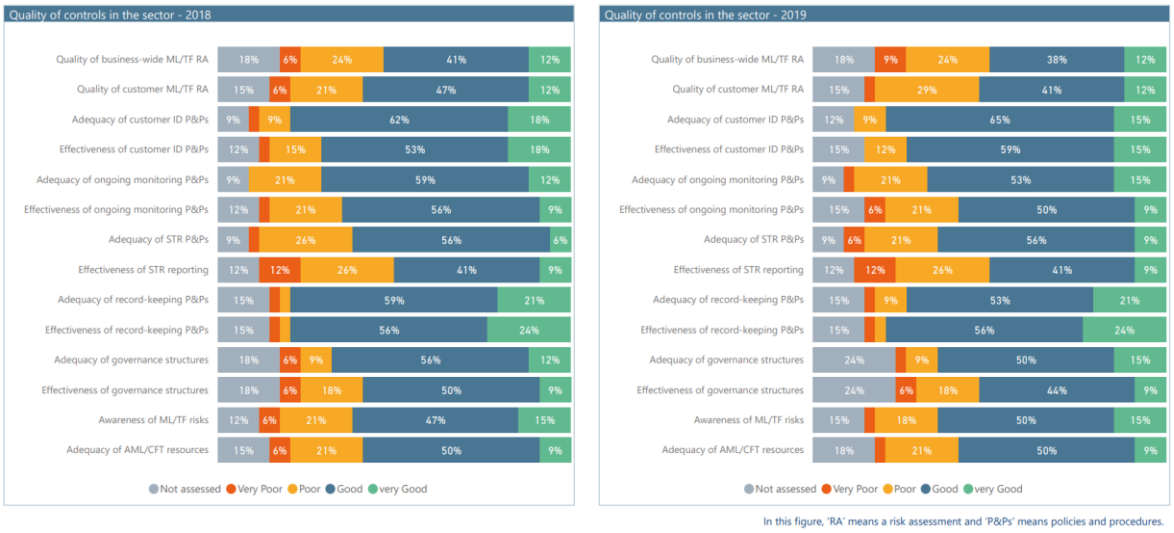
Figure 49: Cross-border inherent ML/TF risks in the sector of investment firms



4.5.2 Quality of controls

138. A large proportion of CAs have indicated that the information they provided is based on both quantitative and qualitative data. Overall CAs assessed the quality of controls within the investment firms sector as good. This assessment is similar to the one of the Joint Opinion 2019. The EBA observes that more CAs carried out assessments of controls in the sector compared to the Joint Opinion 2019.

Figure 50: Competent authorities' assessment of the quality of controls in place in the sector of investment firms



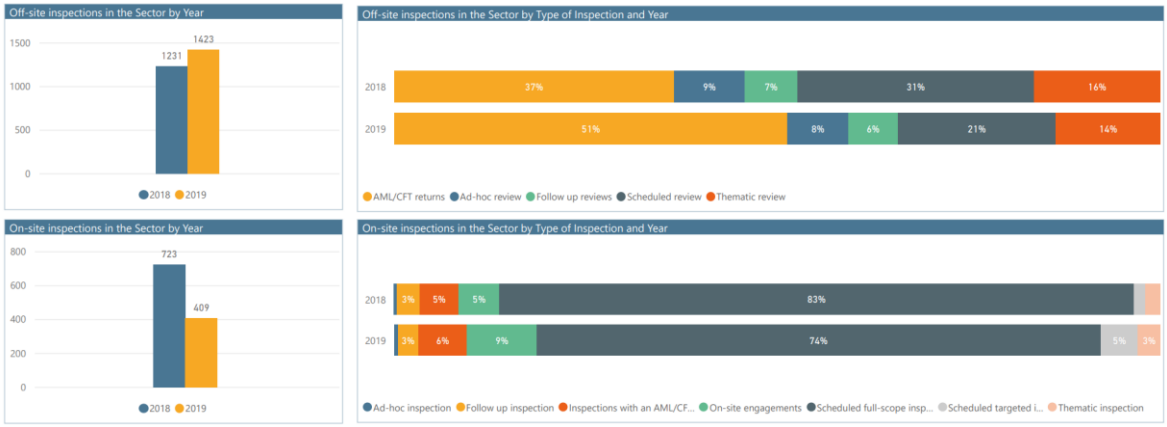
In this figure, 'RA' means a risk assessment and 'P&Ps' means policies and procedures.

139. CAs appeared to be satisfied in particular with the controls related to the adequacy and effectiveness of record-keeping policies and procedures and the adequacy of customer ID policies and procedures. A significant number of CAs were on the other hand concerned about the extent to which STR reporting and ongoing monitoring were effective, and rated these as poor and very poor. This is an important increase compared to the Joint Opinion 2019. The adequacy and the effectiveness of governance structures remain the least assessed controls in this sector.

4.5.3 Supervisory activities

140. In terms of supervisory activities for the sector, most CAs used AML/CFT returns as their preferred off-site tool, and scheduled full-scope inspections for their on-site reviews. The numbers of on-site inspections have decreased considerably from 2018 to 2019, while the use of AML/CFT returns has increased in the same period. A small proportion of CAs indicated they did not carry out any off-site/on-site inspections in either year.

Figure 51: Off-site and on-site inspections in the sector of investment firms



141. CAs appeared to have concentrated their supervisory activities on firms rated with a less significant risk profile, in line with the number of firms rated by CAs in that risk category. Less focus, in both off-site and on-site inspections, was placed on firms presenting significant and very significant risks.

Figure 52: Supervisory engagements based on firms' risk level in the sector of investment firms

4.5.4 Breaches identified

142. The most common types of breaches found in the sector identified by CAs in 2018 and 2019 related to the customer identification and verification, ongoing monitoring, internal controls weaknesses (including overall AML/CFT policies and procedures), suspicious transaction reporting, customer risk assessment and weaknesses in the governance and compliance function. This is similar to the findings of the Joint Opinion 2019. However, the breaches found by CAs in the sector were, for a large part, minor breaches.

Figure 53: Most common breaches identified in the sector of investment firms

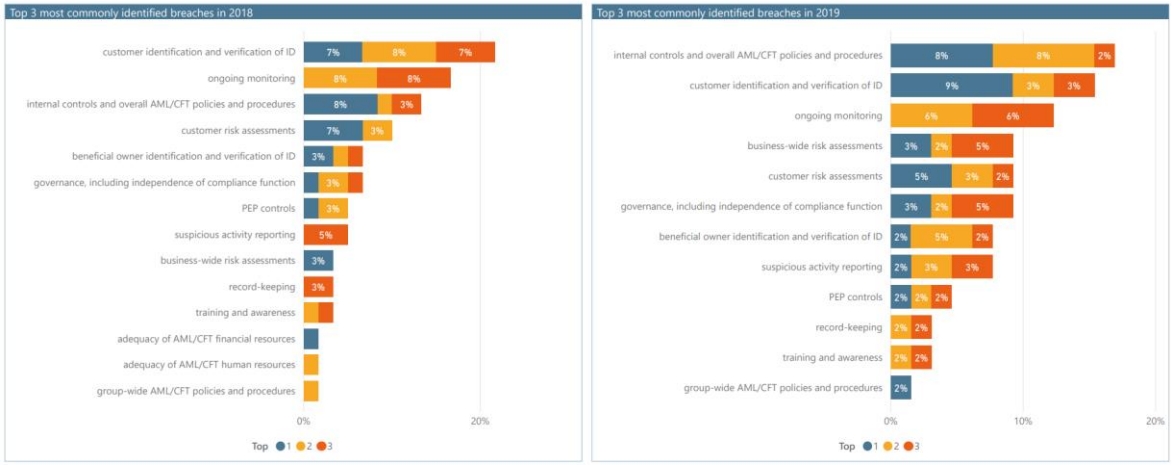


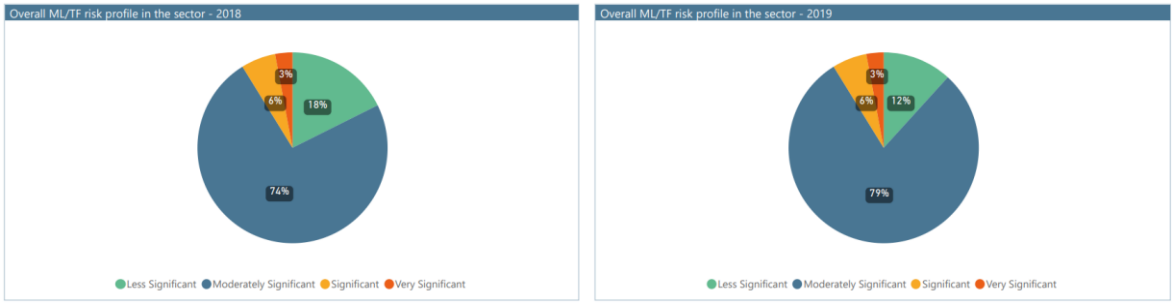
Figure 54: Seriousness of breaches identified in the sector of investment firms

143. CAs most commonly followed up on the breaches identified through orders to comply, orders to implement specific measures or orders to put in place a remediation plan. These measures appear to be in line with the level of seriousness of the breaches identified in the sector.

4.5.5 Overall risk profile of the sector

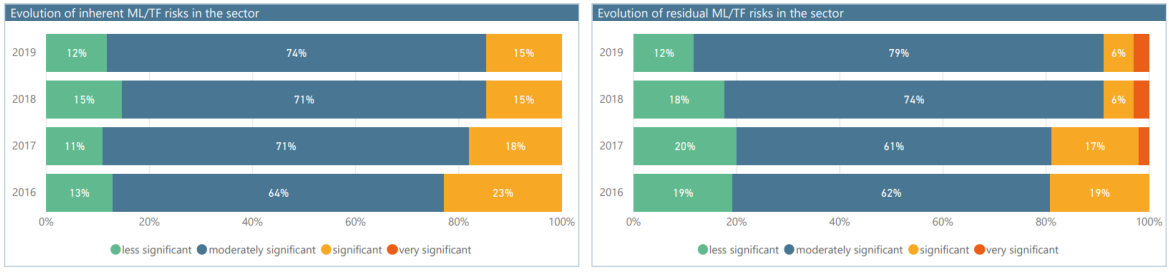
144. The vast majority of CAs assessed the overall risk profile of the sector as presenting a moderately significant level of risk. This shows an increase compared to the Joint Opinion 2019, with more CAs considering the sector as such. This may be attributed to the fact that significant risk overall rating has substantially decreased in the meantime.

Figure 55: Overall ML/TF risk profile in the sector of investment firms



145. The overall risk rating provided by CAs was largely the same as the inherent risk, suggesting that the controls in place may not be sufficiently robust to effectively reduce the risks identified. A small number of CAs reported that the risk had increased, and this was due to poor controls in some key areas, including ongoing monitoring and STR reporting.

Figure 56: Evolution of inherent and residual risk profile in the sector of investment firms since 2016



4.5.6 Emerging risks

146. As part of their identification of emerging risks, a number of CAs identified risks associated with FinTech and the greater role of technology in investment services as key in the sector. The increasing use of technologies in the sector enables a swift approach to processing transactions, which leads to high-frequency trading and may often cause challenges with the identification and verification of customers.

147. A number of CAs have also raised concerns about innovation and new technologies linked to initial coin offerings and virtual currencies, as detailed in section 3.1.1 above.

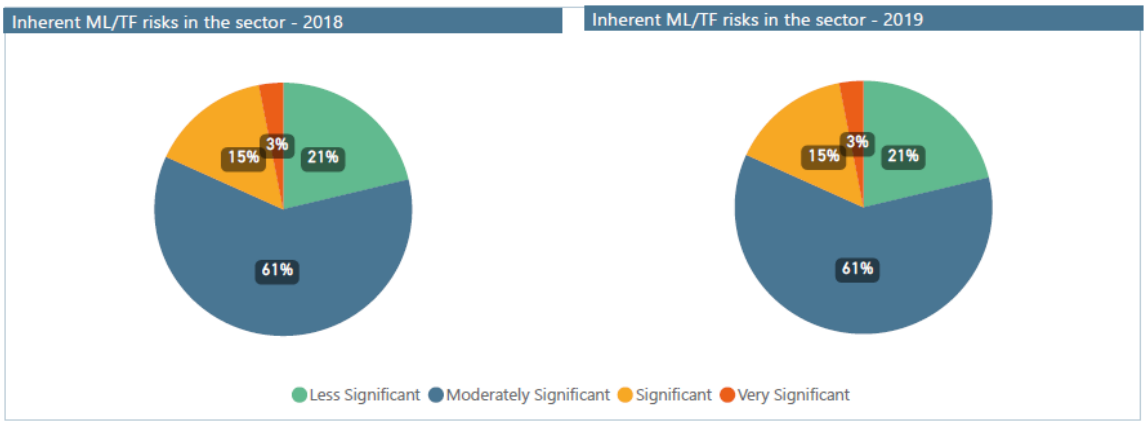
4.6 Collective investment undertakings/fund managers

148. In total 33 CAs which are responsible for the AML/CFT supervision of 17,844 investment funds and fund managers responded to the EBA's questionnaire in respect of data for both 2018 and 2019.

4.6.1 Inherent risks

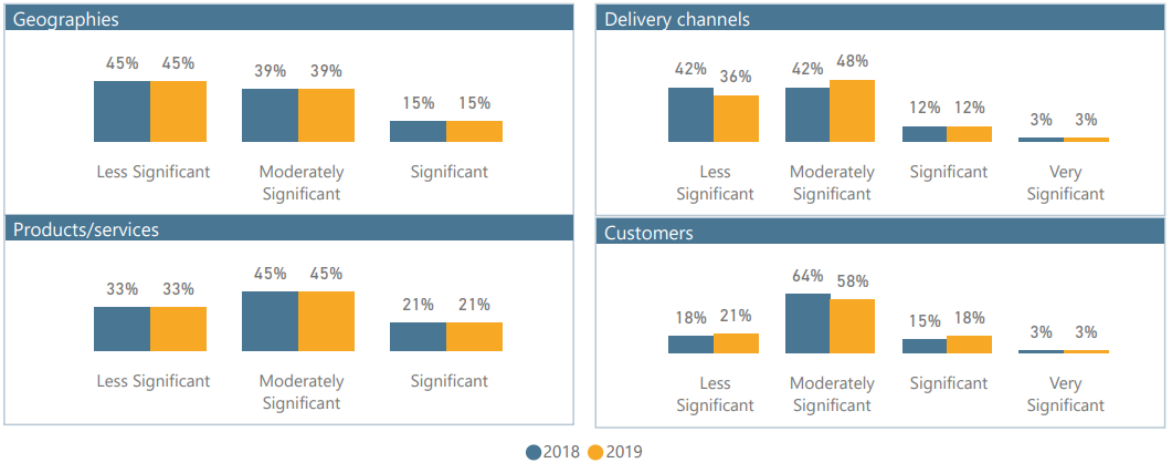
149. The medium to long-term nature of the investment strategy of many funds can limit the overall attractiveness of the sector for ML/TF purposes. The sector is considered by most CAs as presenting a predominantly moderate and less significant risk from a ML/TF perspective. Compared to the Joint Opinion 2019, the number of CAs that assessed the sector as exposed to very significant risks increased slightly.

Figure 57: Inherent ML/TF risks in the sector of collective investment undertakings/fund managers



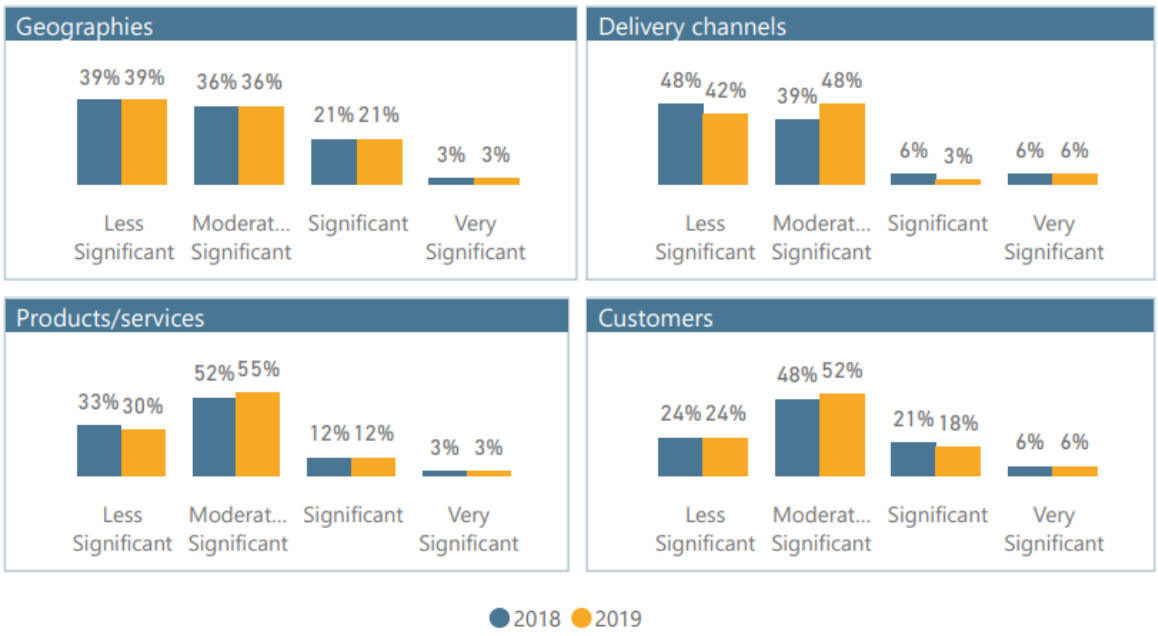
150. Customer and geographic risks were considered by most CAs to be key risks for the sector as a result of, for example, the prevalence in the sector of high net worth individuals, customers with complex structures and customers located in higher risk jurisdictions. Similar to the Joint Opinion 2019, many CAs also pointed to ongoing difficulties by firms in this sector in establishing the beneficial ownership of customers, and risk associated with the distribution channels, as the distribution/marketing of investment funds is often delegated and several intermediaries may be involved in distributing the fund, making ML/TF risk identification and management more complex or challenging.

Figure 58: Inherent risk factors in the sector of collective investment undertakings/fund managers



151. There were divergent views among CAs regarding the risks associated with the sector's exposure to cross-border transactions. Responses by individual CAs were not always consistent on this point, which the EBA believes may have been attributed to the fact that a high proportion of CAs (70%) have based their cross-border risk assessments on an informed estimate only.

Figure 59: Cross-border ML/TF inherent risks in the sector of collective investment undertakings/fund managers



4.6.2 Quality of controls

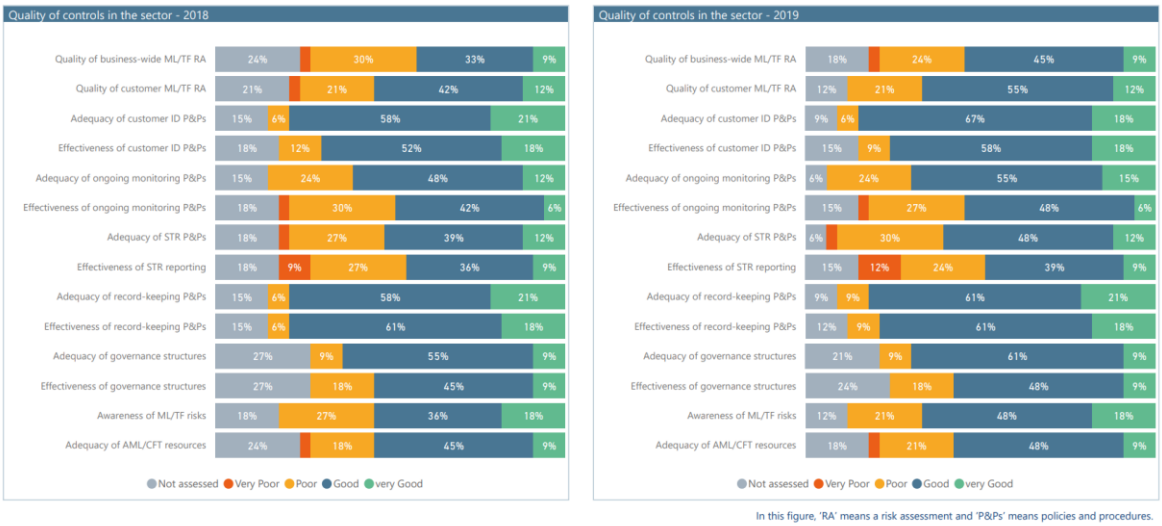
152. The majority of CAs indicated that the data they provided for their assessment of the quality of controls put in place by firms in this sector was based on a formal risk assessment such as the one envisaged in the EBA's Risk-based Supervision Guidelines.

153. The majority of CAs generally rated the quality of controls as good in this sector. In particular, CAs considered both the adequacy and effectiveness of policies and procedures that the sector had put in place to comply with their AML/CFT obligations to be good. This marks an improvement since the Joint Opinion 2019, which found that the policies and procedures were not always applied effectively.

154. At the same time, a sizable proportion of CAs indicated they had not assessed either the adequacy or the effectiveness of governance structures in both 2018 and 2019. This is of concern, given that effective AML/CFT governance and oversight is an essential part of ML/TF risk mitigation and given the level of delegation in the sector.

155. A sizeable proportion of CAs furthermore still assessed the following controls as being poor or very poor in both 2018 and 2019: quality of the business-wide risk assessment; adequacy and effectiveness of on-going monitoring; the adequacy of STR policies and procedures and the effectiveness of STR reporting; and awareness of staff of ML/TF risks including the availability and effectiveness staff AML/CFT training.

Figure 60: Competent authorities' assessment of the quality of the controls in place in the sector of collective investment undertakings/fund managers



In this figure, 'RA' means a risk assessment and 'P&Ps' means policies and procedures.

156. The abovementioned concerns appear to be in line with what was reported by CAs as the main current risks in the sector. A number of CAs also indicated that in their view, a rule-based as

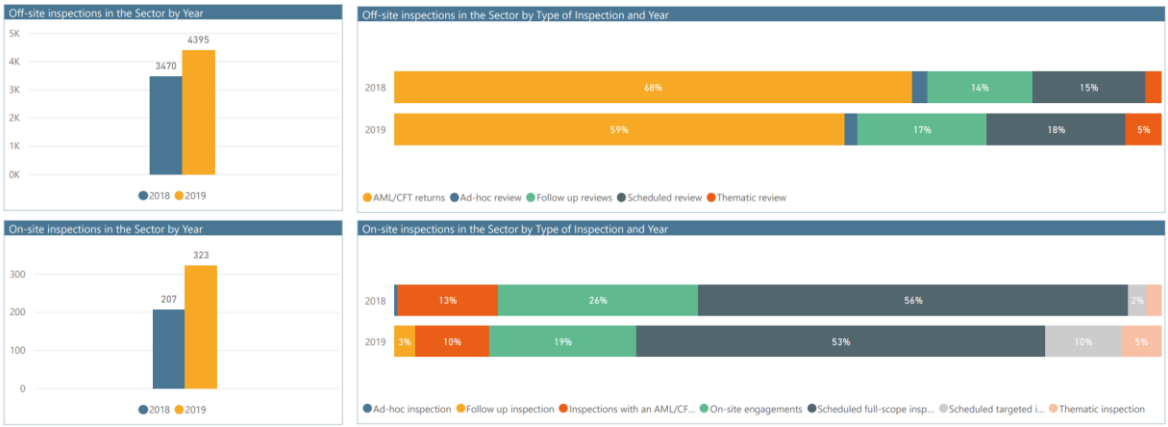
opposed to a risk-based approach to CDD/EDD was sometimes taken by the sector. This may result in incorrect allocation of AML/CFT resources being adopted by firms in the sector.

4.6.3 Supervisory activities

157. The sector received a relatively poor level of supervisory activity in comparison with other sectors. The majority of on-site supervisory activities were scheduled inspections followed by other on-site engagements. However, on-site activities represented a very small proportion of the overall coverage of the sector in both 2018 and 2019. This may be because of the high number of firms in many jurisdictions and the risk rating CAs had given to the sector.

158. CAs indicated that the most common type of off-site supervisory activity conducted in the sector was through AML/CFT returns. Based on the ML/TF risk exposure of the sector, AML/CFT returns may be used by CAs to identify those firms that may be outliers in terms of their risk profile and that may warrant closer inspection.

Figure 61: Off-site and on-site inspections conducted in the sector of fund managers



159. However, from the information provided by CAs, the intensity of supervisory activities appeared not to have been fully commensurate with the ML/TF risk presented by firms in this sector. In particular, there were lower levels of on-site engagements such as inspections for firms assessed as significant or very significant risk in both 2018 and 2019 compared to firms of lower risk. This is not in line with the risk-based approach as set out in the EBAs' Risk-based Supervision Guidelines.

Figure 62: Supervisory engagements based on firms' risk level in the sector of collective investment undertakings/fund managers

4.6.4 Breaches identified

160. CAs have identified a number of breaches. The vast majority of breaches were considered minor or moderate in nature for both 2018 and 2019. However, a small number of egregious breaches were noted in each year.

161. The most common breaches identified in this sector related to internal controls and overall AML/CFT policies and procedures, on-going monitoring and customer identification and verification. This is very similar to the Joint Opinion 2019.

Figure 63: Most common breaches identified in the sector of collective investment undertakings/fund managers

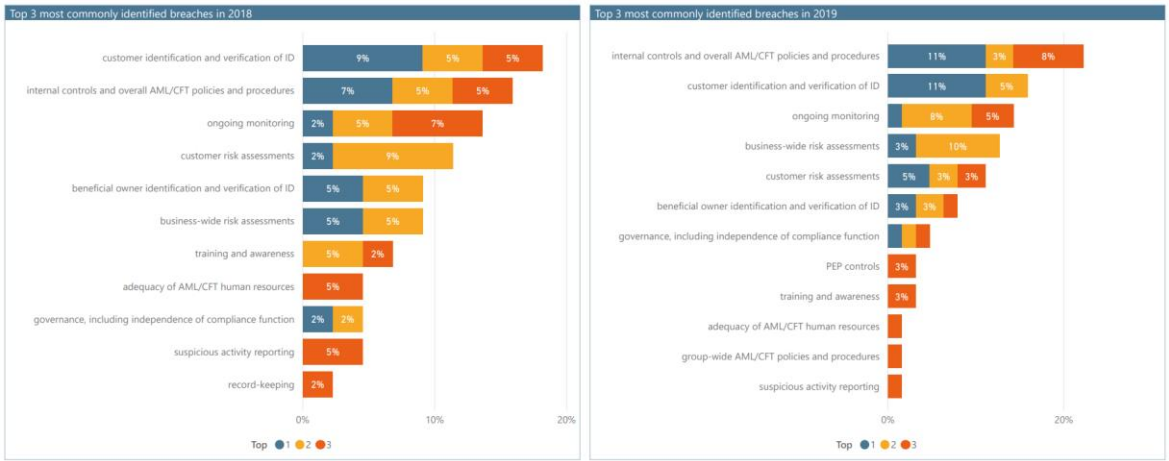
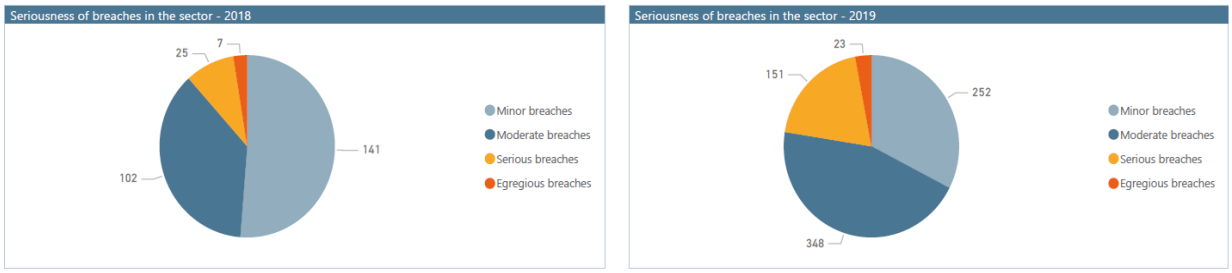


Figure 64: Seriousness of breaches identified in the sector of collective investment undertakings/fund managers

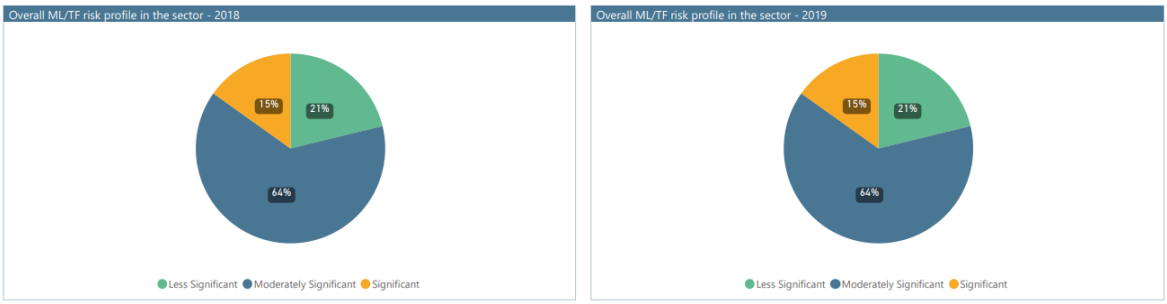


162. Feedback from CAs suggests that CAs have applied similar measures in case of identified breaches irrespective of the severity of the breach. These included requiring firms to put in place a remediation plan, imposing a fine or sanction and/or publishing a warning against the firm.

4.6.5 Overall risk profile

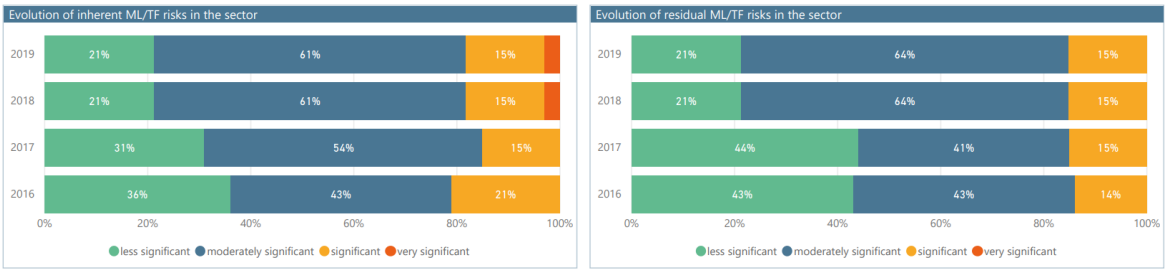
163. After considering inherent risks and controls, a large number of CAs assessed the overall ML/TF risk profile in the sector as moderately significant. This classification remains broadly the same in 2018 and 2019. In most cases, the overall risk rating is the same as the inherent risk rating, leading to the conclusion that, potentially, the controls in place were not sufficient to mitigate the overall risk in the sector.

Figure 65: Overall ML/TF risk profile in the sector of collective investment undertakings/fund managers



164. Similar to the rating of the inherent risk profile of the sector, the overall risk profile for the sector is slightly higher than the Joint Opinion 2019.

Figure 66: Evolution of inherent and residual risks since 2016 in the sector of collective investment undertakings/fund managers



4.6.6 Emerging risks

165. Similar to other sectors, the most common emerging risk referenced by CAs in the sector related to risks associated with FinTech and Reg Tech solutions, in particular the increasing use of new technologies to identify and verify customers, as detailed in section 3.1.2.

166. Another emerging risk referenced by a small number of CAs but worth noting is related to the sector increasingly seeking ways to incorporate higher risk assets such as crypto-assets or real estate into the investment portfolio. It is noted however that the volumes are low as at the date of this 2021 report.

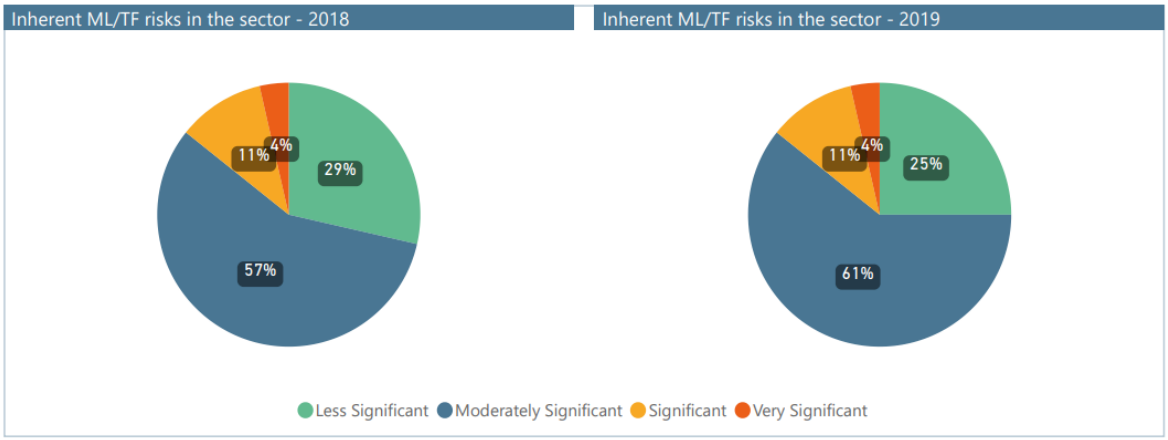
4.7 Credit providers

167. The EBA received responses from 29 CAs responsible for the AML/CFT supervision of 2,912 credit providers (CPs) in total with respect to 2018 and 2019.

4.7.1 Inherent risks

168. Similar to the Joint Opinion 2019, most CAs considered the level of inherent risk in the sector to be moderately significant or less significant, with only a small number of CAs assessing the inherent ML/TF risk as significant or very significant. Just over half of CAs who responded indicated that they provided this rating on the basis of a formal risk assessment such as the one envisaged in the EBA's risk-based supervision guidelines.

Figure 67: Inherent ML/TF risks in the sector of credit providers



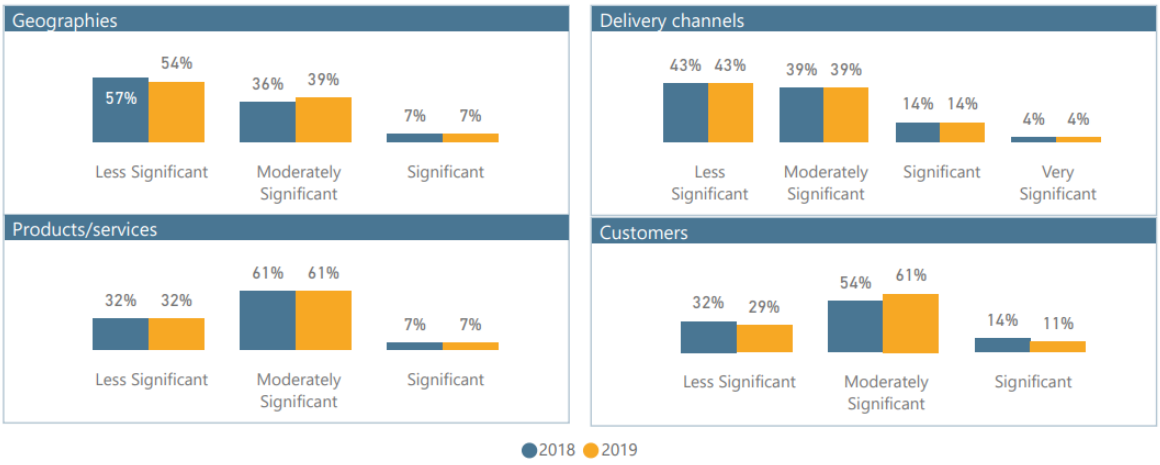
169. Firms in the sector offer a wide range of products and services designed for specific types of customers using a variety of delivery channels, and this may lead to different types and levels of ML/TF risks. For example, consumer CPs often operate through credit intermediaries, with few direct contacts with their customers, and therefore may face difficulties in ongoing monitoring and lack of oversight in the application of CDD measures. On the other hand, factoring, leasing and commercial CPs have different business models and serve different types of customers (trading companies, import/export) and therefore are more exposed to trade-based money laundering.[23] The risk in this sector is also increased when credit intermediaries are used by CPs to distribute their products and services. Over- or under-invoicing in order to create inflated payments and triangulated trade operations that might be aimed at disguising the true destination of funds through the interposition of false beneficiaries was also considered a risk associated with this sector by some CAs. CAs also noted that the sector was vulnerable to being used for terrorist financing purposes, as small amounts of credit can be obtained to finance terrorism.

170. Despite these different business models and similar to the Joint Opinion 2019, most CAs considered that risk factors related to products/services and customers, and to a lesser extent those related to delivery channels, were still presenting moderately significant risks.

171. Furthermore, as the sector is mostly a domestic one in nature, inherent risk factors linked with geography were assessed as less significant by the majority of the CAs. The small proportion of CAs that assessed geographical risks as significant may be attributed to the exposure of some CPs to trade-based money laundering.

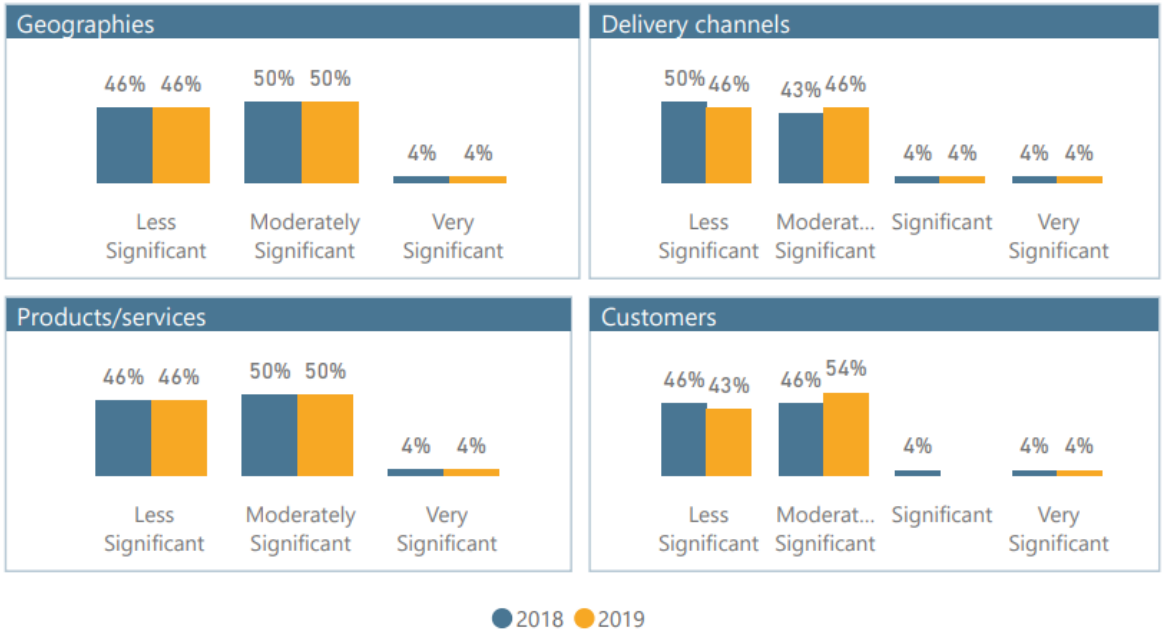
[23] Trade finance products can be abused for money laundering and terrorist financing purposes, for example, the buyer and seller may collude to misrepresent the price, type, quality or quantity of goods in order to transfer funds or value between countries. See for more details: EBA's consultation paper on the risk factors guidelines, February 2020.

Figure 68: Inherent ML/TF risk factors in the sector of credit providers



172. Most CAs moreover considered the sector's cross-border risk exposure to present less or moderately significant risk.

Figure 69: Cross-border ML/TF inherent risks in the sector of credit providers

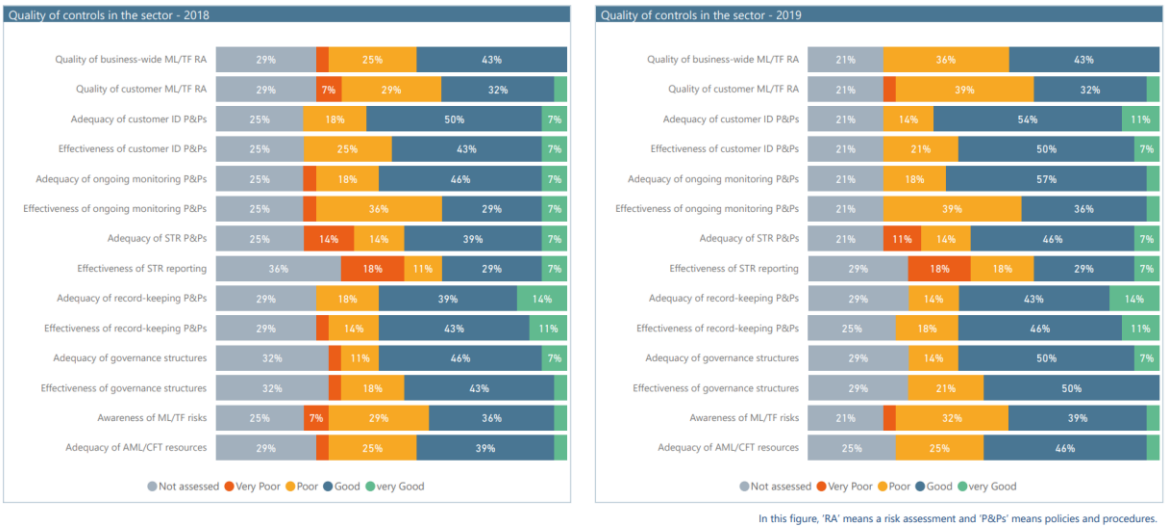


4.7.2 Quality of controls

173. A significant proportion of CAs indicated they had not performed an assessment on the quality of controls in the sector. For those CAs that did perform an assessment, the majority assessed the quality of controls in the sector as either good or very good. However, the quality of customer ML/TF risk assessment was assessed as poor by a significant number of CAs, as was the effectiveness of STR reporting. Furthermore, CAs pointed to often poor level of controls in

the identification and verification of customers. The poor quality of these controls is particularly worrying in this sector in light of the risks that the sector is exposed to from the inherent perspective.

Figure 70: Competent authorities' assessment of the quality of controls in place in the sector of credit providers

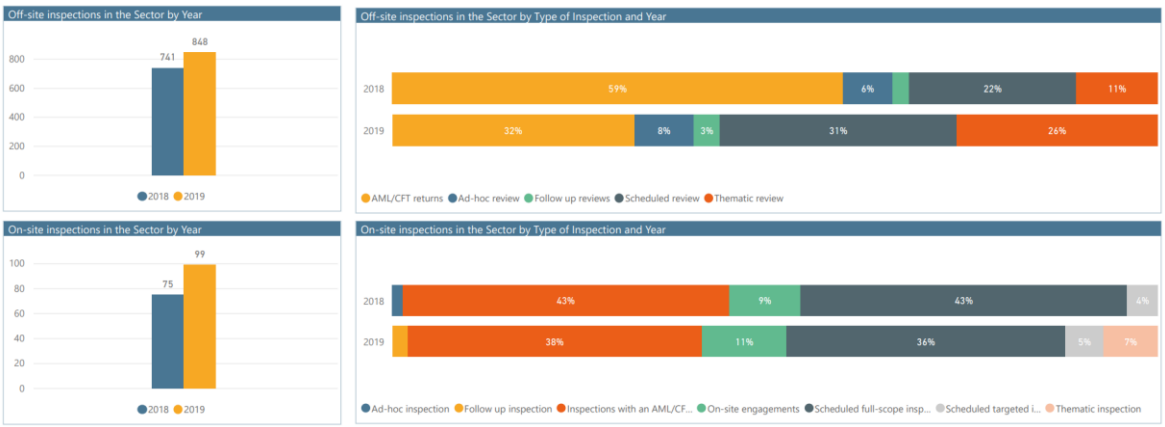


In this figure, 'RA' means a risk assessment and 'P&Ps' means policies and procedures.

4.7.3 Supervisory activities

174. According to the information provided by CAs, the supervisory activities within the CPs sector were mostly conducted on an off-site basis and mainly through AML/CFT returns. Very few CAs indicated they had performed on-site inspections, and many on-site activities in the sector appeared to have been inspections that only included an AML/CFT element.

Figure 71: Off-site and on-site inspections in the Sector of credit providers



175. Most CAs had assessed the level of risk associated with CPs as low, and this was reflected in the population of CPs that were selected for on-site inspections.

Figure 72: Supervisory engagements based on firms' risk level in the sector of credit providers

4.7.4 Breaches identified

176. Most commonly identified breaches in the sector relate to the identification and verification of customers and customer risk assessment, overall AML/CFT policies and procedures and ongoing monitoring. This may be of concern in light of the risks the sector is exposed to and considering that CPs' business is generally based on processing large numbers of loans every day. Most of the breaches identified by the CAs were however rated as minor or moderate.

Figure 73: Most common breaches identified in the sector of credit providers

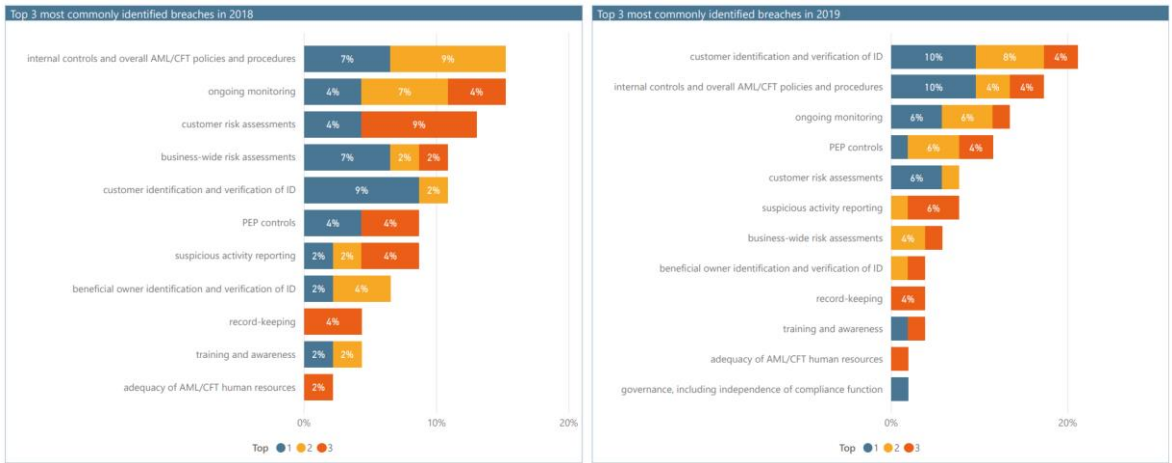
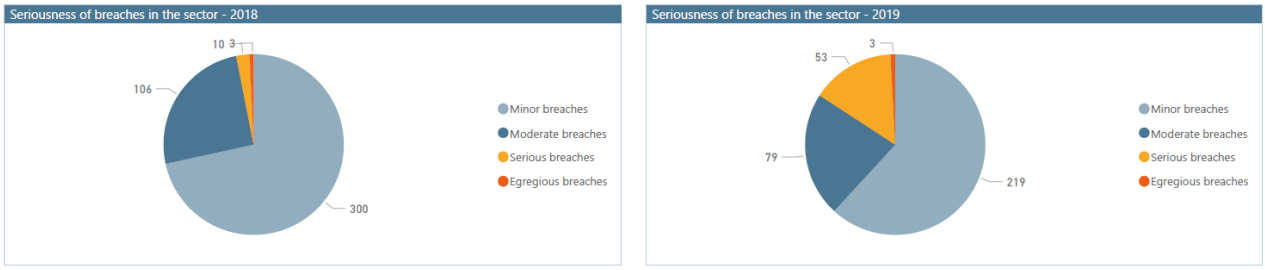


Figure 74: Seriousness of breaches identified in the sector of credit providers

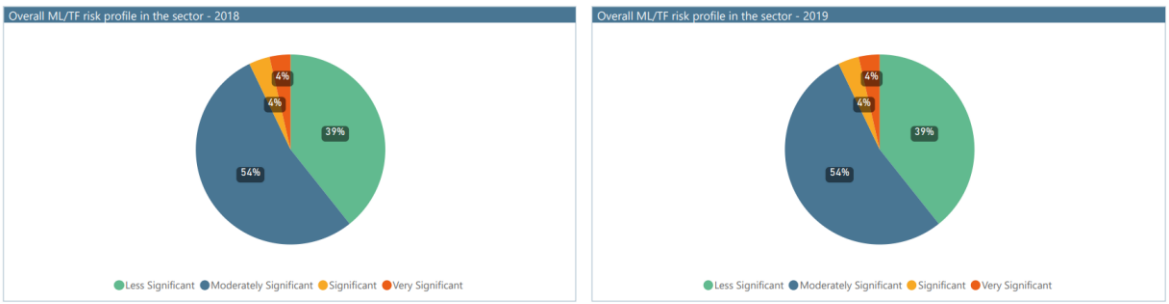


177. The most common follow-up measures applied by CAs within the CPs sector are orders to comply and/or implement measures, followed by administrative pecuniary sanctions, which appear to be commensurate with the seriousness of breaches (mostly minor or moderate) identified by CAs.

4.7.5 Overall risk profile

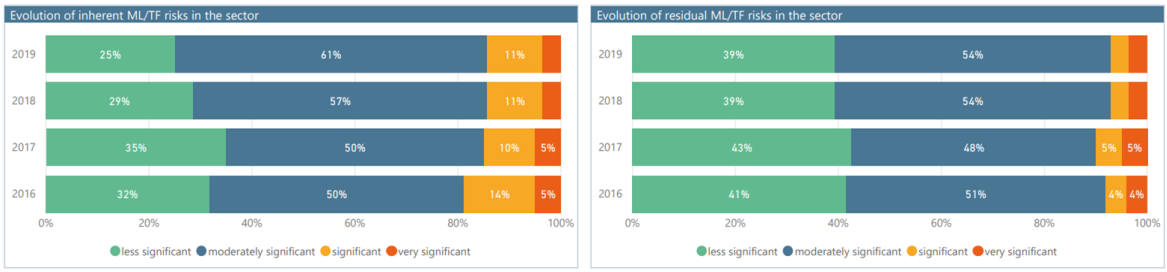
178. CAs consider the CPs sector to have moderately significant or less significant residual exposure to ML/TF risks, with very few CAs considering that the overall risk profile is significant or very significant. The rating of the overall residual risks in comparison to the overall inherent risk profile of the sector seems to indicate the controls in place are sufficient to mitigate the overall risk in the sector; however, as explained above, a significant share of CAs have not performed an assessment of the controls applied by the firms in the sector and it is therefore not clear on what this assessment was based.

Figure 75: Overall ML/TF risk profile in the sector of credit providers



179. Compared to the last Joint Opinion 2019, there is a slight decrease in the number of CAs that considered the inherent risk profile of CPs as less significant and significant in favour of a moderately significant risk assessment. This is also reflected in the residual risk profile of this sector.

Figure 76: Evolution of inherent and residual risk profile of credit providers since 2016



4.7.6 Emerging risks

180. Feedback gathered from CAs indicated that the sector's exposure to the risk of terrorist financing is considered as a key emerging risk in the sector, followed by concerns arising from the increasing use of new technologies, for instance remote onboarding.

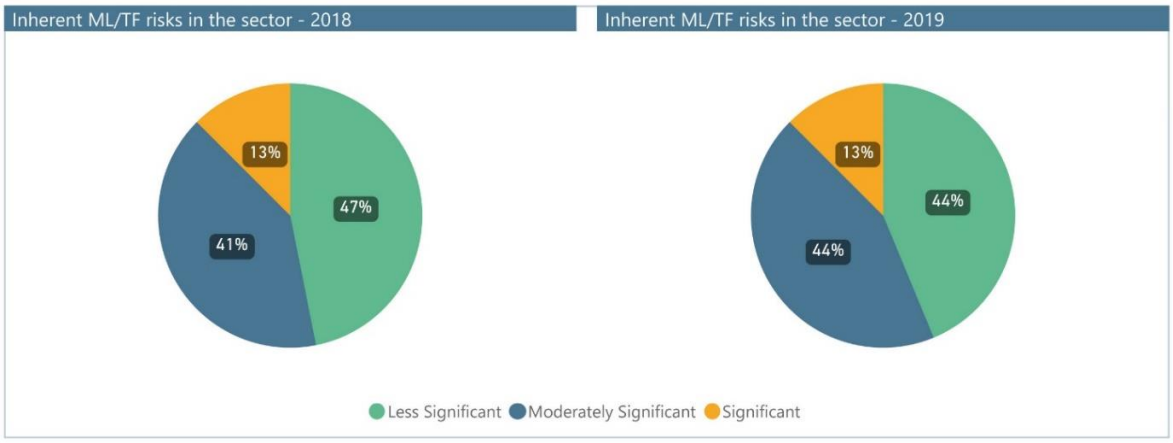
4.8 Life insurance undertakings

181. In total, 32 CAs, which are responsible for AML/CFT supervision of life insurance undertakings (LIUs), responded to the EBA's questionnaire in respect of data for 2018 and 2019. Based on the information received from CAs, there are 1,036 LIUs supervised for AML/CFT compliance in the EU.

4.8.1 Inherent risks

182. Overall, the LIU sector is considered as presenting moderately significant or less significant risk from an inherent ML/TF perspective by the majority of the CAs. Most CAs have based their assessment of inherent risks of the sector on a formal risk assessment, such as the one envisaged in the EBA Risk-based Supervision Guidelines. CAs' assessments of the inherent risk level in the sector have not changed since the Joint Opinion 2019.

Figure 77: Inherent ML/TF risk profile in the sector of life insurance undertakings

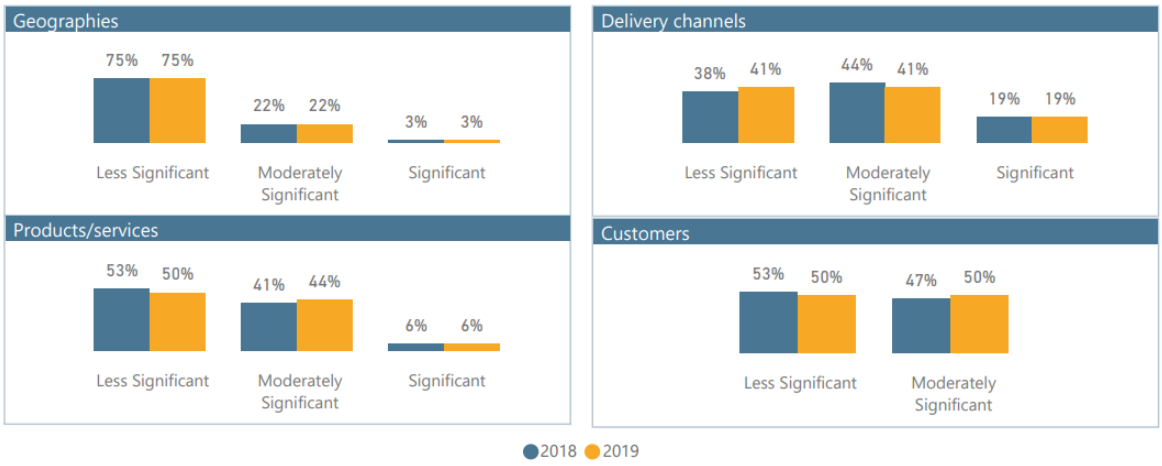


183. Compared with other sectors, LIUs may not be the first choice for ML/TF purposes. However, the sector is very diverse across the EU, and some CAs, especially those supervising a more diversified insurance market or where the LIU sector is significant, identified a number of firms associated with significant risks.

184. Compared to the Joint Opinion 2019, a noticeable change is that delivery channels are now considered to present an increased level of risk. Vulnerabilities in relation to delivery channels are stemming from the operation of intermediaries and agents, which can result in a high number of new customers being identified and verified by third parties, for instance persons acting on behalf of insurance companies. Using intermediaries and agents is more prevalent in insurance than in other sectors and as such constitutes an increasing risk factor for the sector of LIUs. While the use of intermediaries in the LIU sector does not significantly impact on the overall risks of the sector, it does create a possible vulnerability, in that the LIUs are more removed from the customer than if they were offering the service directly.

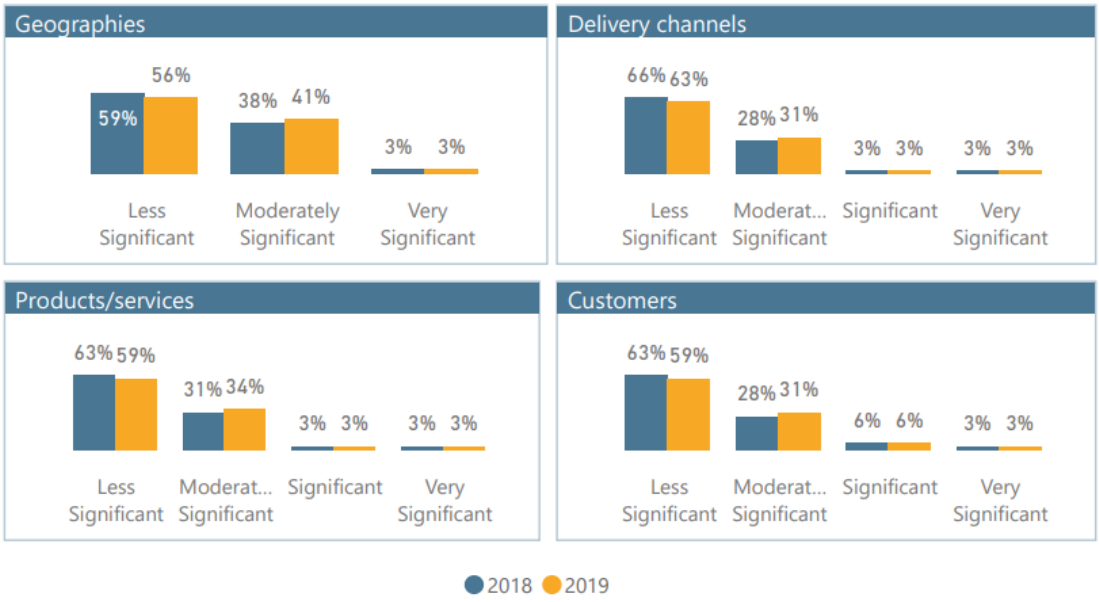
185. Furthermore, most life insurance business contains life insurance policies linked with investment options. Some CAs identified potential risks regarding these investments when the products included single and very high premiums, when the product contained flexible payment options and large sums were accumulated over the lifetime of the product or when early redemption pay-out was requested despite losses for the customers. Main customer risks cited by CAs are the risks associated with PEPs, payments to the customer's accounts abroad, fraud, use of cash, ongoing relationship with customer other than a natural person and a beneficiary other than the customer. However, these customers' risks were still considered as presenting moderately or less significant risks.

Figure 78: Inherent ML/TF risk factors for the sector of life insurance undertakings



186. A large proportion of CAs assessed the sector's inherent and residual ML/TF risk exposure to cross-border transactions as less significant. The reason for this can be the mainly domestic nature of life insurance products.

Figure 79: Inherent cross-border risks for the sector of life insurance undertakings



4.8.2 Quality of controls

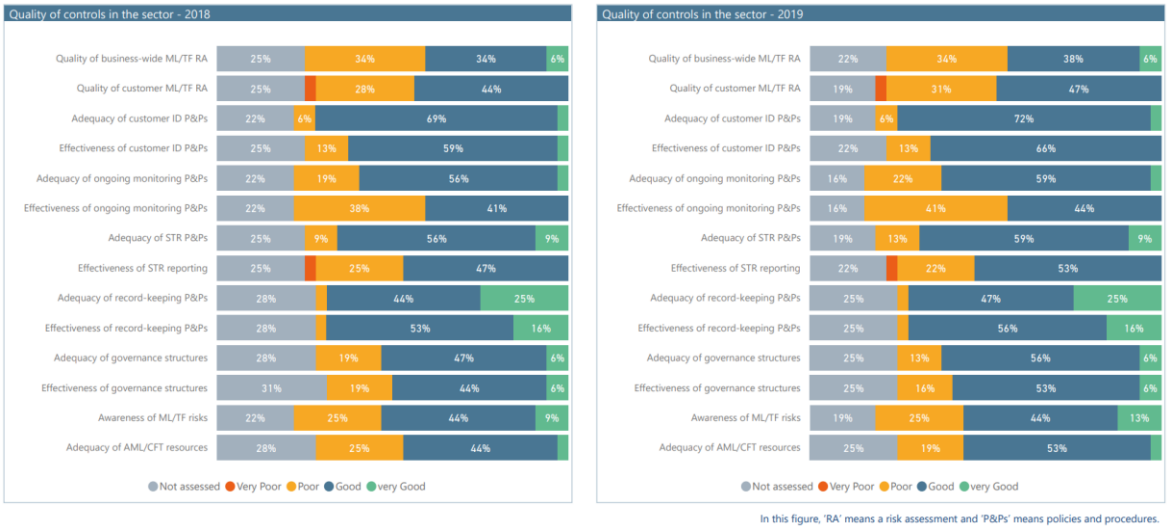
187. Half of the CAs have indicated that the data they provided for their assessment of the quality of controls put in place by firms was based on a formal risk assessment, such as the one envisaged in the Risk-based Supervision Guidelines, and half of them on an informed estimate

of ML/TF risks, which predates a formal risk assessment. Furthermore, a large proportion of CAs (around a quarter) have not assessed the quality of controls in this sector.

188. Overall, most CAs that assessed the controls put in place by firms in the sector rated them as good. This result is similar to Joint Opinion 2019, and CAs appeared to be relatively satisfied with the adequacy of controls related to the policies and procedures, particularly identification and verification of customers and record-keeping. However, they were more concerned about the effectiveness of some of these controls, in particular controls related to ongoing monitoring of transactions and STR reporting, as well as the quality of business-wide and customer risk assessments. This could be explained by the fact that typically LIUs receive less information from the customer after the start of the relationship because of the low frequency and or variability of the transactions afterwards compared to, for example, the banking sector. This however may be mitigated by the fact that the transactions are mostly provided through bank accounts, which are generally covered by effective controls.

189. A significant proportion of CAs that has increased since the Joint Opinion 2019 indicated that the sector's awareness of ML/TF risks was still of concern. This may affect the overall effectiveness of the controls in place.

Figure 80: Competent authorities' assessment of the quality of the controls in place in the sector of life insurance undertakings



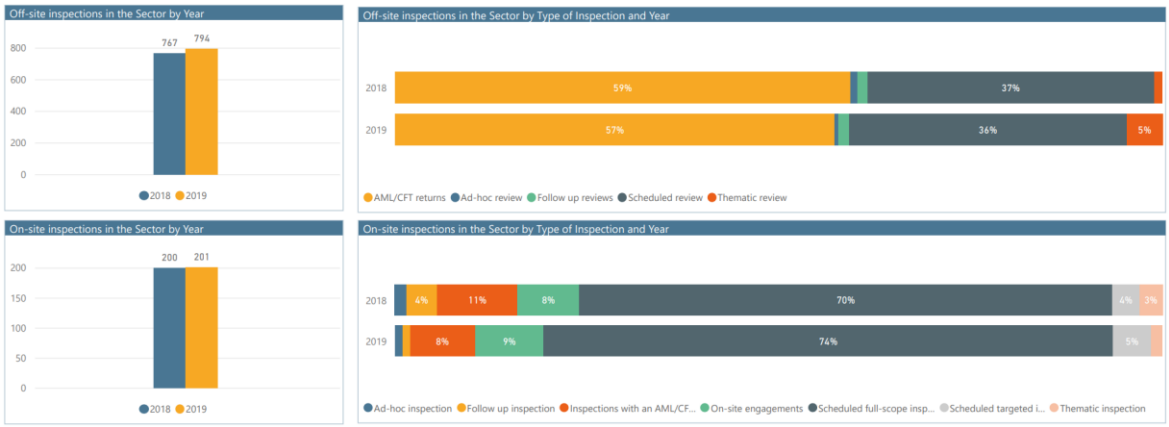
In this figure, 'RA' means a risk assessment and 'P&Ps' means policies and procedures.

4.8.3 Supervisory activities

190. The sector was subject to a relatively poor level of supervisory activity in comparison with other sectors. Not all CAs have conducted on-site or off-site inspections. This may be attributed to the application of a risk-based approach of AML/CFT supervision in the financial market and related allocation of resources and activities, as the life insurance sector is generally considered as presenting lower risk. From the responses received, it appears that the sector was mostly

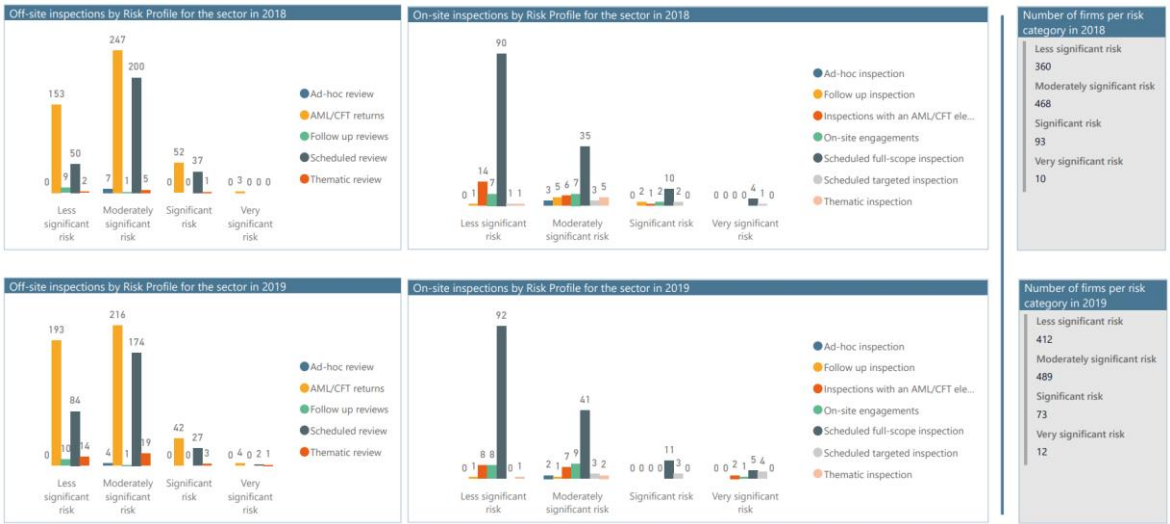
supervised through various off-site engagements, especially AML/CFT returns. Some CAs have also carried out on-site activities with the sector, mainly scheduled full-scope inspections.

Figure 81: Off-site and on-site inspections in the sector of life insurance undertakings



191. The intensity of the supervisory activities appears to be commensurate with the ML/TF risk level CAs attributed to the firms in the sector. The majority of LIUs were associated with moderately significant or less significant risk profile. The volume of firms associated with significant risk profile represented a small proportion and were mostly identified in jurisdictions in which the LIUs sector is more significant and diversified.

Figure 82: Supervisory engagements based on firms' risk level in the sector of life insurance undertakings



4.8.4 Breaches identified

192. As a result of their supervisory activities, CAs identified some breaches in the sector that are considered as minor or moderate. While the number of breaches has grown from 2018 to 2019, this may be attributed to more intensive supervisory activities performed by two CAs and does not necessarily point to an overall trend in the sector.

193. In 2018 and 2019, the type of breaches that were identified by CAs as a result of their supervisory activities were mainly linked to internal controls and overall AML/CFT policies and procedures, customers' and business-wide risk assessments, and customers' identification and verification. Breaches found in the sector are therefore not entirely in line with the assessment of the quality of controls. This may be attributed to the fact that internal controls and customer due diligence is the key element of most supervisory actions in the sector and that AML/CFT supervisory procedures may focus on CDD measures. On the other hand, record-keeping is being assessed as one of the least identified breaches, across both years under review.

Figure 83: Most common breaches identified in the sector of life insurance undertakings

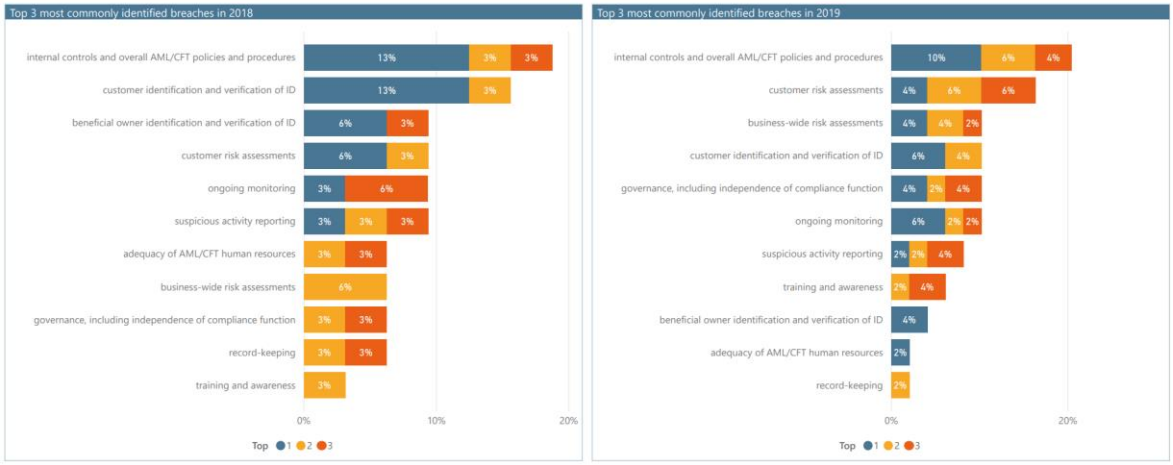
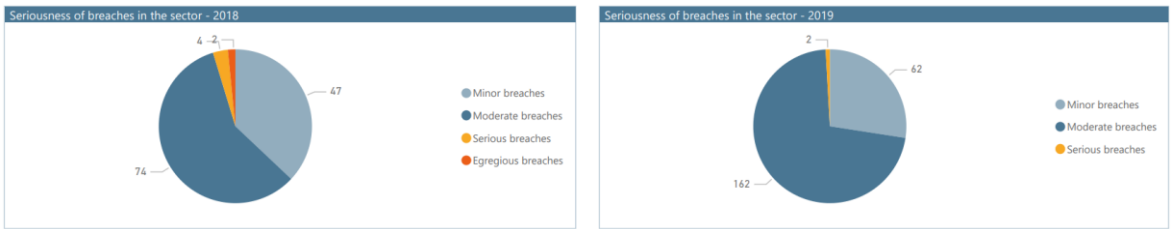


Figure 84: Seriousness of the breaches identified in the sector

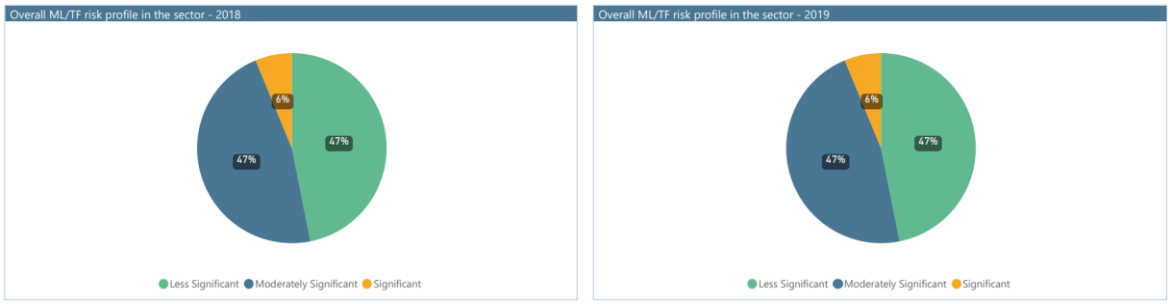


194. Feedback from CAs suggested the most common follow-up measures were orders to implement measures, orders to comply and orders to put in place a remediation plan, in line with the seriousness of breaches (mostly minor or moderate) identified by CAs in this sector.

4.8.5 Overall risk profile

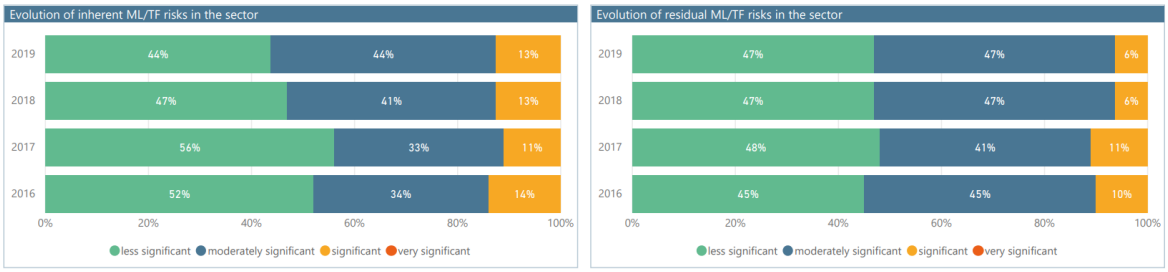
195. As in the Joint Opinion 2019, after considering inherent risks and controls, a significant part of CAs view the overall ML/TF risk profile in the sector as moderately significant or less significant. Very few CAs consider the sector to present significant risk.

Figure 85: Overall ML/TF risk profile in the sector of life insurance undertakings



196. The overall risk profile of this sector has therefore been stable since the last Joint Opinion 2019, with the exception of inherent risks that have slightly moved towards the moderate level. This may be linked to the spread of new technologies and web-based platforms.

Figure 86: Evolution of inherent and residual ML/TF risks in the sector of life insurance undertakings since 2016



4.8.6 Emerging risks

197. According to CAs, the increased use of FinTech and RegTech solutions in the sector appears to be a key emerging risk. CAs are also concerned about the rise of web-based insurance platforms such as 'insurtech' and challenges posed by accounts opened without physical presence of the customer and remote business relationships. Around half of CAs have not identified any emerging risks in the sector.

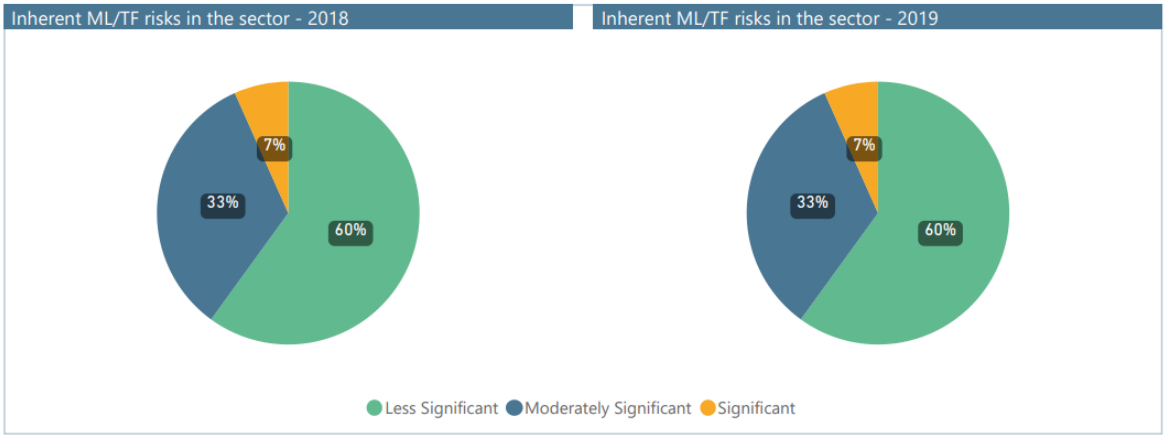
4.9 Life insurance intermediaries

198. In total, 30 CAs, which are responsible for the AML/CFT supervision of 86,663 life insurance intermediaries (LIIs), responded to the EBAs' questionnaire and provided data for both 2018 and 2019.

4.9.1 Inherent risks

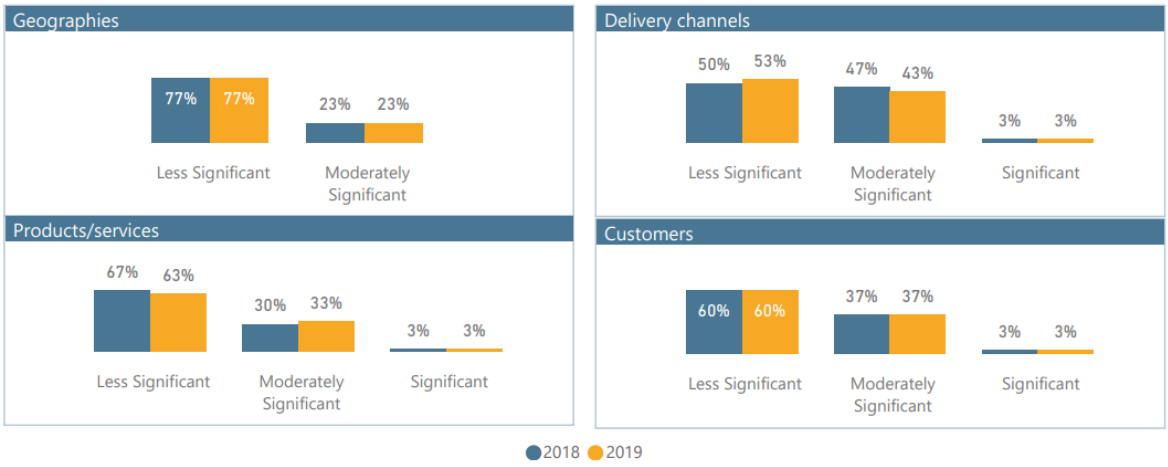
199. The majority of CAs considered the LII sector's exposure to ML/TF risks to be less significant. When compared with life insurance undertakings (LIUs), the level of inherent ML/TF risk associated with intermediaries in the sector is lower because LIIs' responsibilities do not often include handling payments from customers. However, in spite of this, several CAs indicated that this sector may be particularly 'profit-driven' due to its remuneration system, mainly based on commissions. CAs noted in that regard that there is a risk that AML compliance may be affected as a result.

Figure 87: Inherent ML/TF risks in the sector of life insurance intermediaries



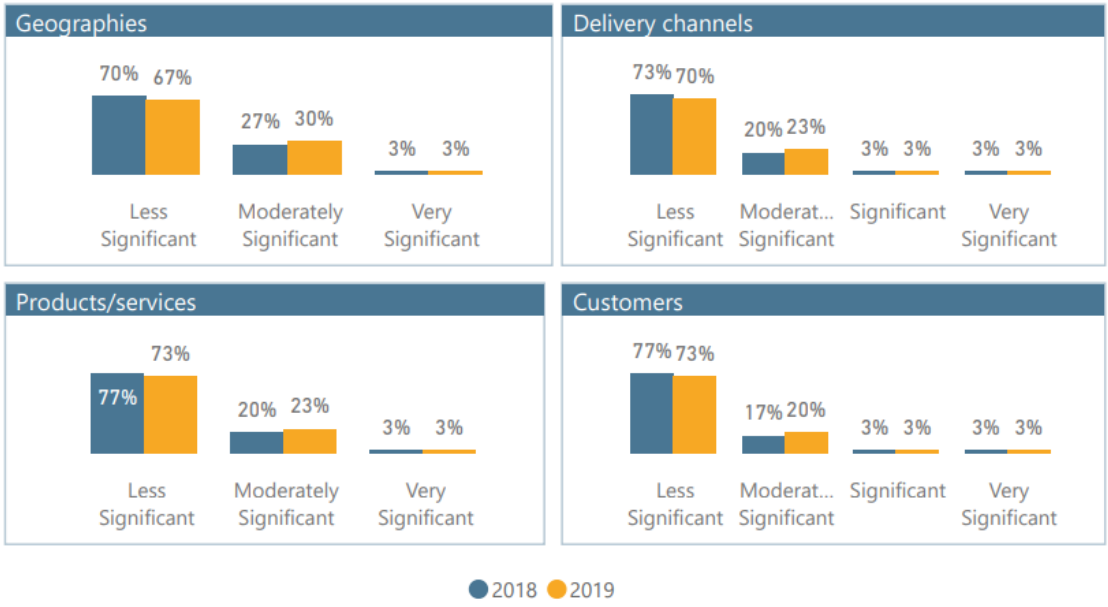
200. A large proportion of CAs assessed the inherent risks factors linked to geographies, customers and products/services as less significant in the sector of LIIs. Delivery channels were rated as moderately significant by more CAs. This may be attributed to the increase of non-face-to-face activities in this sector, as explained below in relation to emerging risks.

Figure 88: Inherent ML/TF risk factors in the sector of life insurance intermediaries



201. The sector's exposure to ML/TF risks related to cross-border transactions was also considered less significant by most CAs.

Figure 89: Cross-border inherent ML/TF risks in the sector of life insurance intermediaries

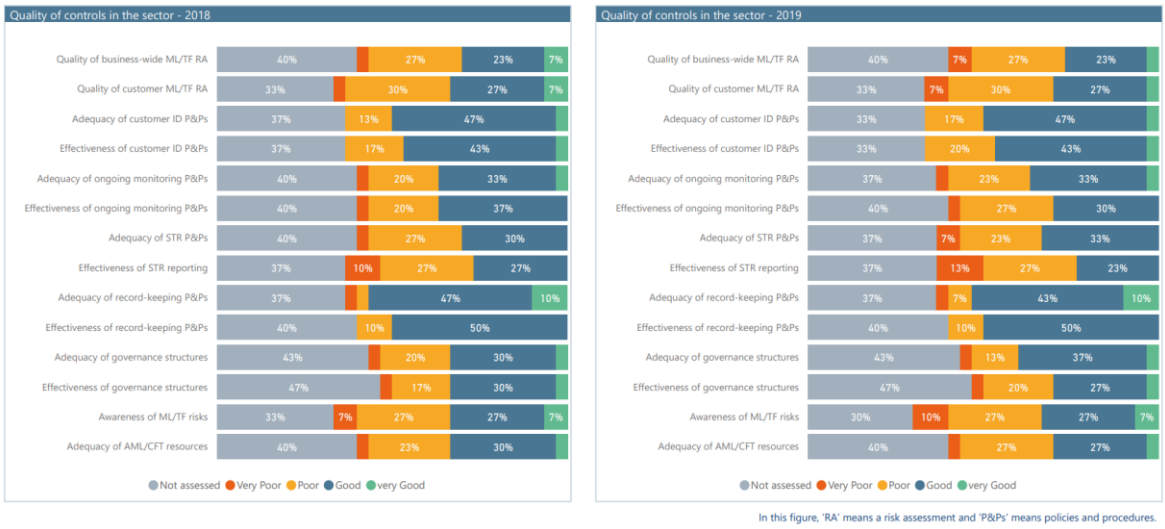


4.9.2 Quality of controls

202. From the responses received to the EBAs' questionnaire, it appears that when CAs have carried out an assessment of controls, they considered that the controls put in place by LIIs were good or very good overall. However, as in the Joint Opinion 2019, a large number of CAs have not carried out an assessment of controls in this sector. This however may be in line with a risk-based approach, as CAs may have focused their attention on those sectors that are more

exposed to ML/TF risks. Nevertheless and in light of the inherent risks referred to above, an assessment of controls would be a sensible course of action.

Figure 90: Competent authorities' assessment of the quality of the controls in place in the sector of life insurance intermediaries



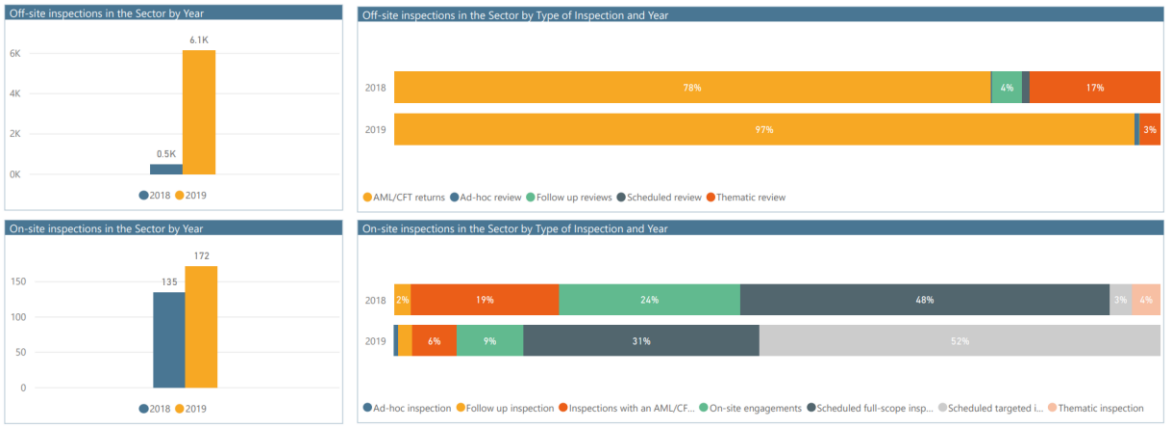
203. Generally, CAs appeared to be satisfied with the controls relating to the adequacy and effectiveness of customer identification and verification policies and procedures, as well as to the adequacy and effectiveness of record-keeping policies and procedures. However, they appeared to be more concerned about the controls relating to the adequacy and effectiveness of STR policies and procedures, the quality of both the business-wide and individual risk assessments and the awareness of ML/TF risks. The latter raises questions as regards the effectiveness of CDD measures. Moreover, a significant number of CAs pointed to problems associated with the level of training provided to the staff in the sector, which was assessed as inadequate.

4.9.3 Supervisory activities

204. More than half of the CAs responsible for the AML/CFT supervision of LIIs did not carry out any supervisory activity in this sector in both years under review, and the sector has been subject to low levels of supervisory activities.

205. When CAs carried out on-site inspections, most of these were full-scope or targeted inspections. As regards to off-site activities, CAs mainly used AML/CFT returns. Between 2018 and 2019, there has been a significant increase in supervisory off-site activities, attributed to the fact that one CA indicated it conducted a large survey covering all LIIs under its supervision in 2019.

Figure 91: Off-site and on-site inspections carried out in the sector of life insurance intermediaries



206. There was some evidence from questionnaire responses that CAs followed a risk-based approach, commensurate with the number of firms in these risk categories. There was also significant supervisory activity with regard to lower risk firms that CAs approached mainly through questionnaires/AML returns.

Figure 92: Supervisory engagements based on firms' risk level in the sector of life insurance intermediaries

4.9.4 Breaches identified

207. CAs identified a small number of breaches in the sector that were mainly classified as minor or moderate. The increased number of moderate breaches between 2018 and 2019 is a result of a large number of inspections carried out by one CA in 2019. From the responses received, it appears that the main breaches were related to the identification and verification of the identity of customers, internal controls and overall AML/CFT policies and procedures, and quality of both the business-wide and customers risk assessments.

Figure 93: Most common breaches identified in the sector of life insurance intermediaries

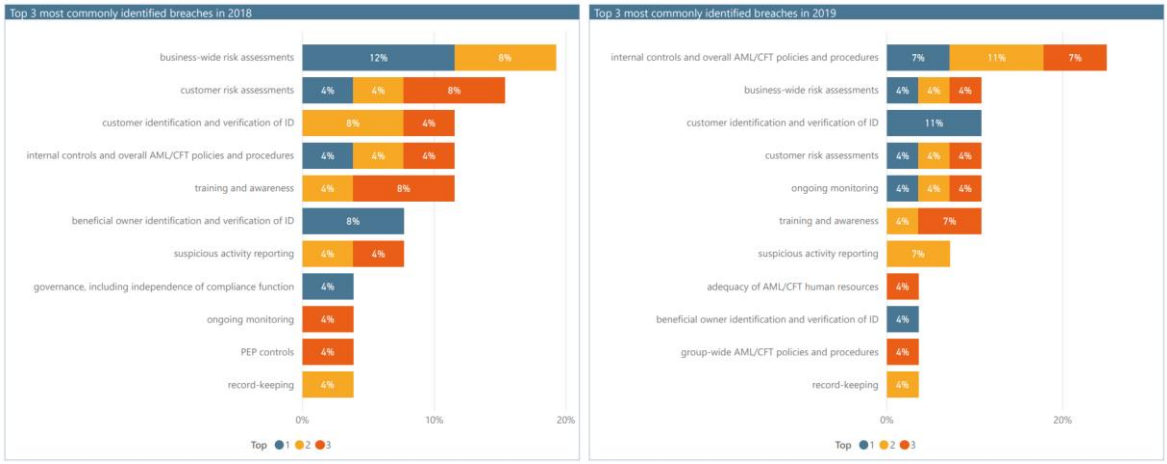
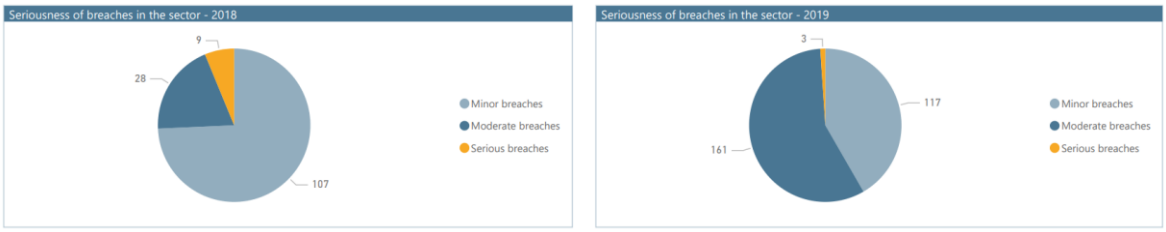


Figure 94: Seriousness of the breaches identified in the sector of life insurance intermediaries

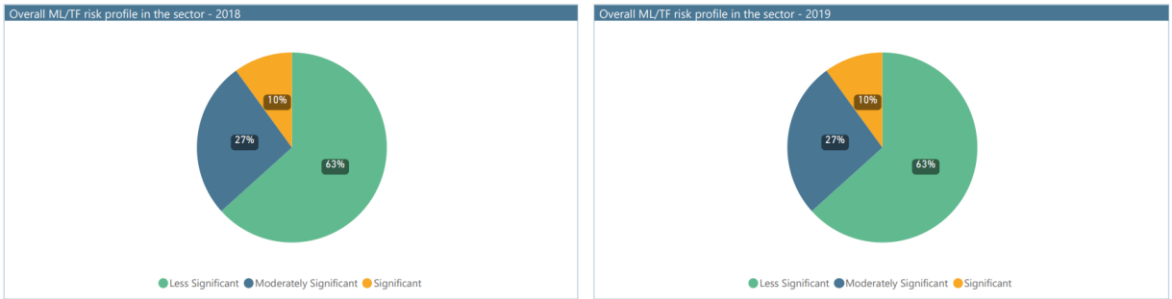


208. The most common follow-up measures applied by CAs to LIIs were warnings, followed by orders to comply and administrative pecuniary sanctions.

4.9.5 Overall risk profile

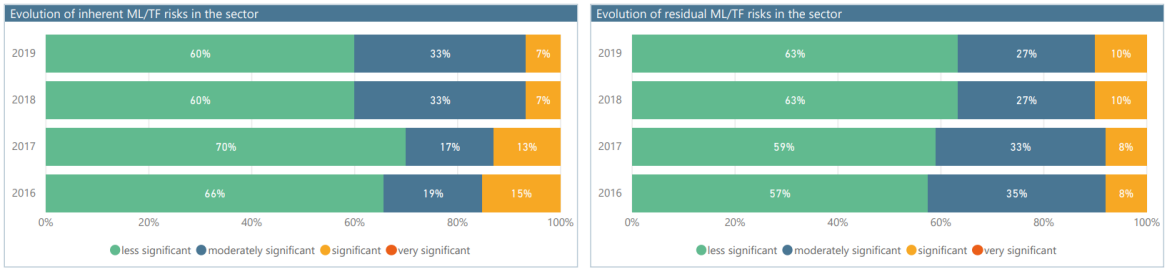
209. As in the Joint Opinion 2019, after considering inherent risks and controls, the majority of CAs view the overall ML/TF risk profile in the sector as less significant.

Figure 95: Overall ML/TF risk profile in the sector of life insurance intermediaries



210. The overall risk profile of this sector remains broadly the same since the last Joint Opinion 2019. The increase in the volume of CAs considering inherent risks as moderate as opposed to less significant since the last Joint Opinion 2019 may be linked to the increase in non-face-to-face activities in this sector.

Figure 96: Evolution of inherent and residual ML/TF risk profile of the LII sector since 2016.



4.9.6 Emerging risks

211. The majority of CAs identified the changes in the delivery channels used by LIIs as an emerging risk due to the increased use of FinTech that include insurtech solutions. Similar to the LIUs, CAs are particularly concerned about the increased use of web-based insurance platforms and associated challenges posed by the identification and verification of identity in remote business relationships.

Annex: Definitions

For the purpose of the EBA's questionnaire to CAs, the following definitions applied:

Scheduled full-scope inspection	means a comprehensive on-site review of a firm's AML/CFT systems and controls that is scheduled in line with the risk-based approach. This assessment is likely to include a review of the firm's policies and procedures and an assessment of their implementation through, *inter alia*, interviews with key personnel, testing of systems used in the AML/ CFT compliance and a review of risk assessment and customer files.
Scheduled targeted inspection	means an on-site review of a firm that focuses on one or more specific aspects of a firm's AML/CFT systems and controls framework. Such a review is scheduled in line with the risk-based approach. This assessment is likely to include a review of the firm's policies and procedures and an assessment of their implementation in respect of the targeted areas for review through, *inter alia*, interviews with key personnel, testing of systems used in the AML/ CFT compliance and a review of risk assessment and customer files.
On-site thematic inspection	means on-site review of a number of firms, often from the same sector, that focuses on one specific or very few aspects of these firms' AML/CFT systems and controls, such as transaction monitoring or the treatment of PEPs. Thematic reviews often serve to help supervisors gain a better understanding of the way specific ML/TF risks are managed by a sector, or particular types of firms.
Ad hoc on-site inspection	means an on-site review, whether comprehensive or focusing on a particular aspect of a firm's AML/CFT policies and procedures, that is triggered by a specific event such as whistleblowing, public allegations of wrongdoing (such as the Panama papers), a new ML/TF typology or findings from another supervisory action such as an assessment of wider internal controls, or findings from an AML/CFT questionnaire.
On-site follow-up inspection	means an on-site review, which is consequent to a scheduled, an ad hoc or thematic inspection/review, and focusses on assessing whether weaknesses in firms' AML/CFT systems and controls framework identified during the scheduled, ad hoc or thematic inspection/review have been mitigated. This assessment is likely to include a review of the firm's written policies and procedures and an assessment of their implementation through, *inter alia*, interviews with key personnel, testing of relevant systems used in the AML/ CFT compliance and a review of risk assessment and customer files.

On-site inspection with an AML/CFT element	means an on-site review of a firm's overall systems and controls framework, which may be scheduled or ad hoc, where the assessment of AML/CFT systems and controls is not the main focus of the assessment but forms part of it. For example, where the main focus of the assessment is on the firm's compliance with prudential requirements and performed by prudential supervisors in conjunction with AML/CFT supervisors that are responsible for the assessment of AML/CFT systems and controls. This assessment is likely to include a review of the firm's policies and procedures and an assessment of their implementation through inter alia interviews with key personnel, testing of systems used in the AML/CFT compliance and a review of risk assessment and customer files.
On-site engagements	means other types of on-site engagements with a firm or the firm's key personnel either at the premises of the firm or at the competent authority. These engagements are likely to include bilateral meetings with the firm's personnel, which are scheduled in line with the risk-based approach. Such an engagement is not part of the other type of on-site inspection.
Scheduled off-site review	means a comprehensive/full-scope off-site review of a firm's AML/CFT systems and controls on the basis of written policies and procedures and risk assessments. Off-site inspections are scheduled in line with the risk-based approach and do not normally involve testing the implementation of these policies and procedures.
Ad hoc off-site review	means an off-site review, whether comprehensive or focusing on a particular aspect of a firm's AML/CFT policies and procedures, that is triggered by a specific event, such as whistleblowing, public allegations of wrongdoing (such as the Panama papers), a new ML/TF typology or findings from another supervisory action such as an assessment of wider internal controls, or findings from an AML/CFT questionnaire.
Off-site follow-up review	means an off-site review, which is consequent to a scheduled or an ad hoc off-site inspection, and focusses on assessing whether weaknesses in firms' AML/CFT systems and controls framework identified during the scheduled/ ad hoc inspection have been mitigated. This assessment is likely to include a review of a firm's AML/CFT systems and controls on the basis of written policies and procedures and risk assessments.
Off-site thematic review	means off-site reviews of a number of firms, often from the same sector, that focus on one specific or very few aspects of these firms' AML/CFT systems and controls, such as transaction monitoring or the treatment of PEPs. Thematic reviews often serve to help supervisors gain a better understanding of the way specific ML/TF risks are managed by a sector, or particular types of firms.
AML/CFT returns	means regular or ad hoc requests to firms for quantitative and qualitative data and information relating to key ML/TF risk indicators.

	AML/CFT returns are different from off-site inspections, in that they are frequently automated and often not comprehensive. Their aim is often to help supervisors gain a better understanding of the ML/TF risks to which their sector is exposed, rather than to assess the adequacy of a firm's AML/CFT systems and controls.
Supervisory action	means action supervisors take to address shortcomings or breaches of financial institutions' AML/CFT obligations. Supervisory action can range from a letter setting out recommendations to the imposition of pecuniary sanctions or the withdrawal of permissions.
Risk	means the likelihood and impact of money laundering or terrorist financing taking place. **Inherent risk** refers to the level of ML/TF risk before mitigation and a firm's or a sector's **overall risk profile** refers to the residual level of ML/TF risk that remains after inherent risks have been mitigated.
Emerging risk	refers to a risk that has never been identified before or an existing risk that has significantly increased. Some of the characteristics of emerging risks may include, but are not limited to, the uncertainty as to their actual significance; difficulties to quantify such risks due to lack of data; they may be outside of financial institutions' or CAs' control.
FinTech	means technologically enabled financial innovation that could result in new business models, applications, processes or products with an associated material effect on financial markets and institutions and the provision of financial services.
RegTech	means the use of new technologies to solve regulatory and compliance requirements more effectively and efficiently.

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