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# the Wolfsberg Group

## Wolfsberg Group

### Country Risk Frequently Asked Questions (FAQs)

#### Preamble

In 2006, the Wolfsberg Group of International Financial Institutions<sup>1</sup> issued guidance on the Risk Based Approach (RBA) to Managing Money Laundering Risks, which set out a number of commonly used risk criteria to measure money laundering risks, including a country risk factor. Since the publication of that guidance, the industry has evolved its understanding of money laundering risks and how to implement appropriate controls to manage those risks. This is particularly true of country risk and its means of assessment, although challenges in this area still remain.

The Wolfsberg Group<sup>2</sup> has prepared these FAQs, based on the members' views on current best practices and, in some respects, on how the Group believes those practices should develop over time. The Group believes that these FAQs will contribute to the promotion of effective risk management and further the goal of its members to endeavour to prevent the use of their institutions for criminal purposes.

It is to be noted here that, while the 2006 RBA paper refers to the management of money laundering risks, this document takes the broader view in vigour today, whereby reference is usually made to financial crime risk, which includes money laundering, sanctions, bribery and corruption risks, financial secrecy and tax transparency.

There is a great deal of debate as to whether financial crime country risk assessments should be considered a model, a methodology, a tool or even an application (see Question 5). This document will use the term methodology for ease of reference, unless explicit reference is being made to a model. The Group is currently working on the issuance of Guidance on Models & Methodologies, which will be published in 2018.

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<sup>1</sup> At the time, the Wolfsberg Group's members were: ABN AMRO, Banco Santander, Bank of Toyko-Mitsubishi, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan, Societe Generale and UBS.

<sup>2</sup> Today, the Wolfsberg Group's members are Banco Santander, Bank of Toyko-Mitsubishi UFJ, Bank of America, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan Chase, Societe Generale, Standard Chartered and UBS. The Basel Institute on Governance was also actively involved in the development of these FAQs.

## Q1. What do we mean by Country Risk in the context of Financial Crime Compliance?

The term “country risk” has typically referred to the additional risk created by investing in, or lending cross border to, a foreign country in the context of credit facilities. With the introduction of the RBA as the overriding principle in the fight against financial crime, country factors (amongst others) were identified as being relevant to assessing the financial crime risk of the customer.<sup>3</sup> These country factors could include a customer’s domicile or country of incorporation, centre of activity or other nexus, such as country of tax residency. Therefore, when assessing a customer’s risk profile, Financial Institutions (FIs) need to consider not only the financial crime risk related to the customer and the customer’s source of wealth, but also the legal frameworks and their effectiveness, as well as the political environment in the countries where the customer is active. For reasons of differentiation, these FAQs will refer to this type of country risk as financial crime country risk (FCCR), which reflects the assessment of whether a particular country’s attributes would result in a higher probability that a customer connected to that country presents a higher risk of financial crime. It is to be noted here that even a higher FCCR should not necessarily preclude business being undertaken in any such rated country, but rather that FIs will need to ensure that the control environment is appropriately robust to manage that risk.

The starting point for effective assessment of an FI’s FCCR rating methodology is based on the FI’s initial understanding of the country’s risks and context in the widest sense, as well as elements which contribute to them. These may cover:

- the nature and extent of money laundering, terrorist financing, corruption, tax evasion risks, amongst others
- factors which could significantly influence the effectiveness of a country’s anti money laundering (AML) and counter terrorist financing (CTF) measures, including the maturity and sophistication of the regulatory and supervisory regime in the country
- legal AML/CTF frameworks
- structural elements which underpin the AML/CTF system, for example: political stability; a high-level commitment to address AML/CTF issues and indicators of financial secrecy
- the circumstances of the country, for example, the relative importance of different parts of the financial sector, the extent to which the economy is cash-based; estimates of the size of the informal sector and/or shadow economy
- other geographical factors such as trading or cultural links, or what are commonly known as nexus risks, where geographic proximity may drive a higher risk rating; this is particularly true for sanctions and terrorist financing considerations

An FI’s assessment of country risk is iterative and subject to factors beyond its control. However, once an FI has defined its FCCR methodology, which has been validated as per the FI’s normal governance process, then it should be used as widely and consistently as possible to inform decisions where country risk is a required factor. Generally, a FCCR methodology is used across all of an FI’s business lines and activities. Any exceptions to this should only be granted under a robust governance process.

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<sup>3</sup> Wolfsberg Statement, *Guidance on a Risk Based Approach for Managing Money Laundering Risks* (2006), Section 5, [http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg\\_RBA\\_Guidance\\_\(2006\).pdf](http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg_RBA_Guidance_(2006).pdf)

## Q2. What data sources should be considered when developing a methodology to assess country risk?

Most assessments of FCCR incorporate both subjective (analysis based or qualitative) and objective (numeric or quantitative) data. Data sets are usually purchased from external vendors or list/index providers, which are then considered alongside the FI's experience of operating within countries and other relevant factors to determine the overall risk rating. The sources used for quantitative risk scoring should cover financial crime relevant risk parameters or dimensions such as:

**i) Criminal Indicators**, such as corruption indices, political risk maps, countries considered to be tax havens, drug corridors, countries susceptible to human trafficking and terrorism, amongst others

**ii) Political Factors**, such as political stability, levels of democratisation, rule of law, human rights considerations, freedom of the press, civil liberties, amongst others

**iii) Regulatory Factors:** expectations from home and host regulators about how to categorise countries from a financial crime risk management perspective, as well as how AML/CTF regimes are assessed by relevant third parties (e.g. FATF Mutual Evaluations Reports)

Depending on an FI's methodology, they may also wish to consider **Economic Indicators**, such as GDP, levels of inflation and debt (Internal and External), the ease of doing business, global competitiveness or unemployment levels, amongst others.

The most important criteria for choosing sources are the reputability, credibility, relevance and quality of the sources and the publishing institution. Sources with no editorial process or with serious allegations against, or challenges to, their content, including completeness, quality of data and the number of countries covered, should be avoided.

There is no prescribed number of sources an FI could or should use in its methodology. However, as a rule of thumb, statistical risk models do not tend to use more than 20 factors. Too many factors will reduce the sensitivity of each factor, therefore the factor will make little contribution to the overall risk score. In addition, the more factors that are included, the more difficult it is for the developer and the users to understand what is driving changes to the overall country risk score of a country, as it becomes challenging to refer back to raw data.

Irrespective of the number of sources used, an analysis of those sources should be undertaken (including Data Quality checks to ensure sources are reliable and the data up to date), combined with the FI's own experiential judgement criteria supported by a robust rationale (e.g. experience of operating in a particular country), which will yield a score; care should be taken to ensure that sources or any qualitative considerations are not duplicative of data inputs already being used so as not to skew the data through a double-counting effect.

No matter which approach is used by the FI, the choice of the sources, the balance between subjective and objective elements and the process for carrying out the evaluation and any decisions affecting Financial Crime Compliance (FCC) outcomes should be documented. If significant deviations from the objective data sets are part of the outcomes, these should be clearly articulated and explained. The final determination of the FCCR ratings should be approved by an appropriate governance forum, with representatives who have appropriate FCC knowledge and sufficient seniority to be able to satisfy regulatory scrutiny. The forum should undertake full validation of the methodology, agree deviations and approve the final ratings.

### **Q3. How often should data sources be refreshed?**

As a general rule, it is appropriate to update ratings annually, following an update of the underlying data sources, as many of these are updated only once a year. It is important to choose a date when all data is current.

Consideration may be given to revising ratings on an ad-hoc basis when key trigger data i.e. items which can have a material impact on the rating, are released. Examples could include:

- Financial Action Task Force (FATF) public statements, published three times a year, demonstrating material deficiencies in the AML/CTF framework in the country concerned
- Countries becoming subject to sanctions or embargoes
- Regime change through a coup d'état or significant political unrest
- Significant changes to a regulatory framework or legislative changes, e.g. a new EU Money Laundering Directive<sup>4</sup> or an addition to the FATF list of predicate offences
- The publication of a national risk assessment<sup>5</sup>

The process for updating the country risk ratings should be clearly set out in the FI's FCCR governance documentation.

### **Q4. How should Sanctions be considered in country risk methodologies?**

In most cases, FIs default sanctioned regimes to the highest risk banding in their country risk methodology. These countries may be in violation of international law and have made little progress towards complying with international mandates (e.g. from the UN). Regulators generally expect that an FI's relationships with customers associated with sanctioned countries are subject to the highest levels of due diligence and approvals. An FI's presence (both where it is based geographically and also in which markets it does business), may determine which economic and trade sanctions it should comply with. Then the FI may source a list of sanctioned regimes from individual regulators' websites or, in an aggregated fashion, from third party providers.

It is important to consider the reasons why certain countries are sanctioned, what risks are present and how that is linked to financial crime. For example, if the cause for sanctions is terrorism and terrorist financing, then the methodology needs to consider what data is used to measure the risk of terrorist financing.

A separate consideration may be made as to whether the methodology's purpose and usage is related to sanctions compliance. An FI may consider what the scope of its methodology is and how it will be used, e.g. in manual and automated financial crime prevention processes. For example, where the methodology is used to define transactional risk in transaction monitoring, this may relate to the risk of money laundering. Where the FCCR ratings are used to drive customer sanctions screening only, this may relate to sanctions risk only. Where the methodology is not used for sanctions compliance, the strength of the sanctions data or considerations may be reduced. The general practice is for both sanctions and money laundering to be included in a FCCR methodology. FIs should be prepared to present separate or combined money laundering and sanctions country risk assessments depending on the FI's regulatory, operational and governance drivers.

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<sup>4</sup> For example, in the 4<sup>th</sup> EU MLD, the application of Simplified Due Diligence (SDD) or reliance is no longer be a de jure statutory right, rather it will be governed by the RBA and will need to be informed by EU member states' individual risk assessments.

<sup>5</sup> Countries' publication of a national risk assessment as per the FATF Recommendations (R1). National authorities, agencies or organs of state publish a plethora of analyses which vary in terms of prescriptiveness and impact on financial services. Taken individually, the impact of these analyses or position papers may be quite clear but when all this information is taken as a whole, FIs can potentially be led to reach quite different conclusions. For Global FIs the challenge will be how to manage the impact of very different national risk assessment results, notably in home regulator markets, across the overarching spectrum of their operations.

An FI should determine whether comprehensive and/or partial sanctions may be integrated into the methodology logic. Specially Designated Nationals (SDN) sanctions are not considered to have geographical relevance as they are specific to individual persons or entities. The effect of the inclusion of different types of sanctions on downstream processes and systems should be considered. In some instances partial sanctions are specific to a certain market segment or activity and there may be a more appropriate methodology used for complying with these sanctions. For example, if the sanctions are banning the supply of petroleum and related products to a particular country, the risk may be more effectively addressed by focussing on the industry type of the FI's customers rather than a blanket approach of focussing on a country as a whole. Conversely, an FI can pursue a broader approach by considering nexus to a sanctioned country, i.e. economic ties between countries. This methodology element captures the risk of an economic partner being exposed to the risks present in a sanctioned country by dealing with that country. This element of the methodology may be more judgmental than data driven as not all neighbours or economic partners may be faced with the same level of risk and remains difficult to operationalise.

Sanctions may change very quickly as political, diplomatic or economic issues arise or are resolved. In general, the effect of sanctions is immediate, therefore it is important for FIs to keep abreast of any changes and be quick to respond. It is also important to consider what processes and systems the FI uses to comply with sanctions and thereby what the sanctions mean to the FI's FCCR methodology.

#### **Q5. What models or methodologies are available to FIs to measure country risk?**

There is ongoing debate amongst financial crime subject matter experts (SMEs), and indeed amongst regulators, as to whether FCCR assessment considerations and outputs should be considered a model, a methodology, a tool or even an application. In the absence of an industry standard as to whether the different means of measuring financial crime risk (e.g. FCCR or customer risk assessment) should be considered models,<sup>6</sup> we would note that the majority of our members do not consider these means of measurement as models but rather methodologies (or tools or applications).<sup>7</sup>

These methodologies, while not subjected to the same kind of quantitatively focused independent model review as with credit models for example, are nonetheless subjected to a robust governance process, including a form of independent review and validation by competent third parties.<sup>8</sup> Ultimately, therefore, it is the view of the Wolfsberg Group that the decision as to whether an FI's FCCR rating mechanism is a model, a methodology or something else, should be determined by the governance protocols and modelling standards of each individual FI and any relevant regulatory requirements. This document will use the term methodology for ease of reference.

As has been noted by the Basel Institute on Governance, "ranking countries according to their risk of money laundering and terrorist financing presents several methodological challenges. To date, there has been no universally agreed definition or methodological approach that prescribes whether a particular country represents a high risk."<sup>9</sup> Instead, most custom FCCR indices used by FIs, as well as

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<sup>6</sup> From a regulatory standpoint, only the US Office of the Comptroller of the Currency (OCC) has a specific definition of, and requirements associated with, models and model governance. The OCC definition of a model is: "a quantitative method, system, or approach that applies statistical, economic, financial, or mathematical theories, techniques, and assumptions to process input data into quantitative estimates. A model consists of three components: an information input component, which delivers assumptions and data to the model; a processing component, which transforms inputs into estimates; and a reporting component, which translates the estimates into useful business information." Office of the Comptroller of the Currency Supervisory Guidance On Model Risk Management, April 4, 2011: <http://www.occ.treas.gov/news-issuances/bulletins/2011/bulletin-2011-12a.pdf>

<sup>7</sup> The Group is therefore working on the issuance of Guidance on Models & Methodologies, which will be published in 2018.

<sup>8</sup> A third party in this instance makes reference to someone who may be indirectly involved but is not a principal party to the development of a methodology, i.e. somebody who has the competence to understand the content, while maintaining sufficient independence to challenge relevant parts of the development process.

<sup>9</sup> Basel Institute of Governance, Basel AML Index 2015 Report

“off-the-shelf” vendor products, use a composite index to reduce FCCR to a number or category (e.g. red/amber/green).

Although there are a number of “off-the-shelf” commercial products that produce FCCR ratings based upon various publicly available data sources, most FIs do not use such products as their sole approach to measuring FCCR (see Question 6). Rather, the outputs from such vendors may be used as additional data sources to a bespoke in-house built index or as a basis of comparison to gauge the output of an FI’s internal FCCR index. Furthermore, proprietary or customised methodologies represent an objective view of any given FI’s risk appetite, thereby allowing for a consistent application of the methodology across the FI’s footprint with minimal risk of interpretation issues.

Since there is no universally agreed upon approach to determining FCCR, many FIs, and vendors alike, integrate experiential judgment or subject matter expertise into their approach to sense check that the output of the FCCR rating process behaves as expected, in line with those individuals’ unique historical experience within each jurisdiction, where such knowledge and experience exist. Governance committees within FIs should utilise subjective experience to ensure individual ratings are valid, plausible and continue to capture the latest developments in the area of financial crime risks. The output of the FCCR rating process should be suited to each FI’s unique risk profile, knowledge and appetite. Depending on the use of this element of subjectivity in the country risk rating process, the FCCR assessment may not be formally considered a “model” in the same way as a more purely quantitative driven model might.

**Q6. What should FIs consider if they choose to purchase and use an off-the-shelf commercial product to determine their FCCR ratings?**

Some FIs may opt to purchase an “off-the-shelf” commercial vendor product to determine their FCCR ratings. Should an FI consider solely using such a vendor product, it should first become familiar with the choice of data sources, methodologies, modelling parameters and validation processes used by the vendor to determine country risk ratings. In particular, the FI should, in a manner consistent with their risk tolerance, be satisfied, at a minimum, that:

- the vendor’s product has produced a documented set of FCCR ratings which matches the FI’s view of risk
- the vendor’s product includes the risk parameters or dimensions noted above
- the information used by the vendor is refreshed on a periodic basis.

FIs should ensure that the vendor can produce documentation rationalising their choice of data sources, methodologies, modelling parameters and validation processes such that the FI and any authorised third party understands how the ratings were achieved. The FI should confirm that this documentation may be shared with regulatory supervisors, as needed.

**Q7. Is there a standard/conventional methodology to assess country risk?**

There are a number of approaches for assessing FCCR, which may be combined or used independently, these include, but may not be limited to:

- Statistically-based methodology: this approach uses various statistical tools to combine lists and to reach a final FCCR score or classification

- Calculation of weighted average score: FIs' experts assign a weight<sup>10</sup> to each input category or list, where the final score represents a weighted combination of inputs
- Zero risk approach: this methodology assumes a starting point of zero risk and adds negative risk factors to the score

Usually, the result of any assessment is expressed either as a number or a classification (e.g. low, medium or high risk). There are usually common features spanning approaches:

- An FI should identify the various data inputs and output categories that it wants to consider
- Lists come in many types and therefore a clearly articulated process to “normalise” the different lists into a numeric point scale should be implemented. Lists can be normalised by using mathematical algorithms, including different types of scaling.
- A decision should be made as to whether to rank all countries (e.g. as per UN list of recognised jurisdictions) or to rank selected countries (e.g. when excluding small or uninhabited territories)
- Subject Matter Experts should review and approve the outputs of any methodology

Regardless of the approach adopted by an FI, the means by which it conducts its assessment should be appropriately documented so that the rationale can be clearly understood.

#### **Q8. How can financial institutions test and validate the effectiveness of their FCCR Models or Methodologies and how frequently should this be undertaken?**

Assuming that an FI has defined its FCCR rating process as a model, then that model should be subject to the normal cycles of model governance, which includes quantitative and qualitative validation. The intent of any model validation process is to verify that models are performing as expected, in line with their design objectives and business uses. The model validation process confirms, via continuous analysis and communication, that the model and its outputs are fit for purpose. Validation may identify issues which lead to model development activity or an approved change process as part of model governance. The effectiveness of any given model should be tracked regularly to check the model is working effectively and to identify areas that require improvement. This ongoing monitoring can be undertaken through the use of Key Performance Indicators (KPIs) and periodic reviews. Each FI will develop KPIs in line with their normal assessment criteria but KPIs are usually defined through qualitative user feedback and quantitative analysis and used to assess the performance of the model, identify problems and examine whether governance processes are being followed correctly. Examples of KPIs include model sensitivity,<sup>11</sup> volatility, benchmarking against vendor tool ratings (which can serve as a useful sense check as to any discrepancies in ratings versus expected outcomes) or against peer FIs.

Where an FI has chosen not to define its FCCR rating process as a model, but rather a methodology,<sup>12</sup> then any review should occur in line with the minimum standard of review of the underlying data sources, i.e. at least annually. A review will look to address previously identified areas of improvement since the last review and assess any external factors that may affect country risk. The reviews may include SME input, trend analysis and/or compliance with industry norms and regulatory obligations/expectations. It should also review and re-validate the coverage of the methodology (i.e. which jurisdictions, dependencies and territories are included in the assessment).

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<sup>10</sup> Not every input needs to be weighted equally

<sup>11</sup> Model sensitivity analyses how much a country's final score moves based on a range of changes (both realistic and unrealistic) to the underlying data input to the model

<sup>12</sup> Or tool, or application; the terminology will be specific to each FI.

Regardless of the way an FI defines its FCCR rating process, there should be a sufficiently robust governance process around the selection of data sources, the development of any scoring mechanism, SME input, change control processes and some form of independent review and validation so that the outcomes are justified, documented, stable and effective.

#### **Q9. How should an FI deal with missing data points?**

Depending on whether the list of countries being rated is a universal list (e.g. as per UN list of recognised jurisdictions) or a non-universal list (e.g. when excluding small or uninhabited territories), there may be a desire to substitute missing values, whether missing list values or countries that were not rated on any list. The substitution may be with either the highest risk level, the lowest risk level, or an average risk score or proxy value (a value identified for a number of rationalised reasons as likely for the country with missing data). In particular, if a statistical methodology is used, defaulting list values can produce poor results by making countries that should naturally be high risk, appear as low risk. Any defaulting decisions should occur after the methodology is created unless a rationale is developed to support inheriting data from other comparable jurisdictions.

Given that unknown information is *a priori* a risk factor, there should be a data quality assessment done when data is missing, and if there appears to be a paucity of information for a particular country, a subjective override should be assessed for that country. If a data source is limited in terms of the number of countries it covers, appropriate consideration should be given to the impact of this on the output. If data source limitations are identified on a wholesale basis then consideration should be given to not using the data source in question or, as a minimum, mitigating any negative impacts on outputs should be addressed.

Regardless of the FCCR methodology used, it should account for missing data in lists and/or countries, either by elevating the country with missing data to a higher risk or by deciding not to include the country for consideration in the rating process but rather subjectively risk rating that particular country. Either way, it is important that countries with missing data do not automatically become more risky than countries with risky data points, especially when applying a statistically based methodology.

#### **Q10. Should overrides or discretionary risk rating changes be allowed?**

In very limited circumstances, manual overrides and/or discretionary rating changes to FCCR ratings may be envisaged, although these should be subject to a stringent rationalisation and governance process. There may be occasions when an FI will need to consider in-country intelligence, other additional risk factor dimensions or apply expert judgement that may not be factored into existing FCCR rating methodologies. However, overriding FCCR ratings derived from credible sources can present significant risks, such as, but not limited to:

- Interference with the FCCR methodology and results places the integrity of the methodology at risk. Recurring overrides are typically an indication that, in some respect, the methodology is not performing as intended or has limitations or its scope and purpose has not been well defined.
- Inexplicably excluding or ignoring objective risk input criteria from which the methodology produced rating is derived exposes the FI to regulatory, compliance, operational and reputational risk. For example, despite information regarding a country's well-known primary risk of drug trafficking/corruption and a methodology produced rating of 'high,' the FI approves a downgrade in rating due to the fact that the country's AML/CTF regulatory regime is considered acceptable. As a result, customers from this country would potentially not be



subjected to enhanced transaction monitoring or undergo enhanced due diligence which could result in the FI failing to identify, and thereby possibly facilitating, the flow of illicit funds.

- Failure to ensure uniform compliance with risk rating standards through complete internal reviews. The process of reviewing and approving override requests in a vacuum and/or as part of an ad-hoc request could potentially result in inconsistent application of ratings across similarly situated and risk rated countries.
- The more discretion an FI is permitted in overriding and the greater the number of those permitted to exercise override authority, the greater the interference to the methodology which may result in undermining the robustness and quality of the data and/or overall methodology. It is imperative that discretion is limited, properly controlled and governed by the appropriate risk control or FCC function. Whenever there are high risk factors present, the higher and more independent the override approval obtained for the decision, the better.

Individual countries may need to check for specific local regulatory requirements to be considered in any FCCR methodology. If there are indeed local regulatory requirements, these should be brought to the attention of the methodology owner for submission as a dispensation or a localisation process. Any change request should have clear rationale (copy of the local regulatory requirements) and appropriate FCC sponsorship; all approvals will be documented as per the methodology governance process.

As previously mentioned, overrides or discretionary risk rating changes should be very limited. In order to minimise the risk, supporting documentation should include, as appropriate, a detailed risk-based rationale for the override/change and details on how the residual risk of not complying with the risk rating(s) generated by the approved methodology will be mitigated. Approved exceptions should be assigned an expiration date and be required to be reviewed at least annually or more frequently if significant changes in regulatory guidance or geographic developments necessitate.

**Q11. Who should maintain ownership of the FCCR Methodology and what kind of resources are required?**

The FCCR Methodology should be owned centrally by a group-level unit which is independent from the business. Depending on the respective organisational structure within a specific FI, the FCC or AML function would serve as an appropriate owner given the regulatory responsibility of that function and overarching governance and control principles which underpin it. The same may apply to any other independent risk function. However, operational maintenance may be delegated to another relevant unit outside the function (e.g. an intelligence or analytics unit), which nonetheless takes direction from, and/or reports into, the FCCR methodology owner.

Any unit which owns and/or maintains the FCCR methodology needs to be sufficiently equipped with the required regulatory and financial crime SMEs. In particular, resources should have a profound understanding of the conceptual framework of, and methodologies associated with, country risk assessment, respective data sources considered, inter-linkages of country risk assessment with other internal AML principles and methodologies, as well as any other relevant information and industry trends in that area. Analytical and technical modelling skills including statistical expertise serve as basis for the development of a robust methodology. A good understanding of the geographic footprint of the respective institution in terms of locations and/or customer base is beneficial so that the unit can pay special attention to FI or local regulator specific criteria.

While an independent unit should own and maintain the FCCR methodology, it is recommended that relevant subject matter experts and stakeholders, such as business lines, other risk functions and relevant back office functions, are included in the development of the methodology.

## **Q12. Who are generally the users of the assessment results and how are the ratings disseminated?**

There are multiple users of FCCR ratings across an FI, ranging from the Lines of Business, which should understand and evaluate the specific risks associated with doing business in, opening accounts for customers from or facilitating transactions involving, different countries. In this sense the FCCR ratings will feed (along with other factors) the FI's Customer Risk Assessment framework, which will rate a customer so that appropriate levels of Customer Due Diligence (CDD) are undertaken, and their transactions or activities monitored accordingly. Furthermore, FCCR ratings will be taken into account when undertaking Enterprise Wide Risk Assessments (including the assessment of sanctions and bribery and corruption risks),<sup>13</sup> setting thresholds and scenarios for transaction monitoring systems and can be considered in significant business strategy decisions, as well as influencing the costs of operational processes.

Once they have been approved by an appropriate governance forum, ratings should be disseminated to all relevant stakeholders involved in CDD, transaction monitoring, various system owners and the appropriate Reference Data Management team for implementation within a set timescale. Any delay beyond the date set or deviation from the FCCR ratings should be agreed in line with the FI's FCC policy or procedures. Records of the ratings, all changes and the rationale/evidence for any deviations as well as the date they were enacted in each customer/transaction system should be maintained. As part of the methodology implementation governance process, details of the systems into which these FCCR ratings are input locally should also be maintained. This process is designed to ensure that the FCCR ratings are implemented in relevant systems within the timeline prescribed and an assurance process is in place to ensure that they are applied consistently across relevant systems, Lines of Business or Countries.

## **Q13. How should the FCCR rating methodology drive CDD and Enhanced Due Diligence (EDD) requirements?**

In principle, CDD requirements that have to be applied to mitigate or avoid ML/TF risks should correlate with the level of customer risk as determined by each FI's customer risk rating framework, of which country risk is one of the key elements. EDD is applied to mitigate risk emerging from relationships with "high risk" customers. The FCCR methodology assumes that countries with a "high risk" rating generally bear higher inherent risk. For as long as an FI maintains customers domiciled in, manages customers' assets in, or transfers funds originating from these "high risk" countries, there is an increased likelihood of the FI being exposed to ML/TF.

There are other risk factors which should be taken into account when determining any given customer's risk level in relation to a country, including but not limited to:

- the country/ies of source of wealth and source of funds of the customer, ultimate beneficial owner or controlling parties
- the purpose of the customer relationship, products and services and the frequency of transactions
- specific industries, sectors and business activities

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<sup>13</sup> See Wolfsberg FAQs on Risk Assessment for Money Laundering, Sanctions and Bribery & Corruption (2015), <http://www.wolfsberg-principles.com/pdf/faq/Wolfsberg-Risk-Assessment-FAQs-2015.pdf>

Relevant risk factors should be taken into account when determining the respective requirements for CDD, both at on-boarding and at periodic review, which may in turn determine any appropriate EDD requirements.<sup>14</sup>

#### **Q14. Should an FI have a country risk assessment expressed as a country risk rating?**

FIs should consider the level of granularity they require from the country risk assessment output, which will depend on the usage of the methodology outputs in FCC processes and systems. Some FIs prefer using a country score as it gives them a more precise level of risk differentiation (e.g. a numerical score in a customer risk assessment engine or transaction monitoring system). Other FIs prefer using a country risk rating (e.g. low, medium, high) as it gives them an output that certain manual processes can use more easily (e.g. in political exposed person (PEP) due diligence). Still others may prefer using a traffic light symbol or colour which presents a more visual indication for individual users to work with. The output can include other elements that provide greater insights (e.g. a negative/positive trend direction or comments about disputed territories associated with the country).

FCCR ratings are usually considered in the following activities, although it is to be noted that this list is not exhaustive:

- Portfolio analysis: what percentage of a FI's customer base, or overall customer assets, are derived from high risk countries?
- Risk profiling and capital allocation: how much capital does an FI have to allocate in accordance with the risk profile of the FI's portfolio?
- Due diligence requirements: should CDD or EDD be applied?
- Screening and Monitoring: to what extent, at what frequency, at which thresholds, against which scenarios?
- Risk appetite: how much risk is an FI prepared to accept?
- Approval process: what governance processes and approval levels are required to accept certain levels of risk and who should own that risk?
- Periodic or Event Driven Review process: how often should periodic reviews be conducted, to what level and by whom?

In short, the rating becomes the driver for a number of processes that are the core elements for any financial crime control framework in a risk based control environment.

Ultimately, however, FCCR rating methodologies will only determine ratings that define the inherent risk of a particular country. How an FI then manages that risk through its controls, their effectiveness and iterative understanding of how to use country risk in the context of risk appetite and risk acceptance will further determine considerations as to, amongst others, presence in, acceptance of customers from, or transactions to and from any given country.

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<sup>14</sup> Wolfsberg Statement, *Guidance on a Risk Based Approach for Managing Money Laundering Risks* (2006), [http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg\\_RBA\\_Guidance\\_\(2006\).pdf](http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg_RBA_Guidance_(2006).pdf)