Association Luxembourgeoise des Compliance Officers

HOW TO CRAFT AN EFFECTIVE AML RISK APPETITE STATEMENT FOR LUXEMBOURG REGULATED ENTITIES

01. INTRODUCTION

AML risk management is a paramount concern for financial institutions and regulated entities in Luxembourg. The Commission de Surveillance du Secteur Financier (CSSF) enforces stringent regulatory requirements to prevent money laundering and financing of terrorism. This AML Risk Appetite Statement delineates the levels of risk the entity is willing to accept and manage while adhering to applicable regulations.

The purpose of a RAS is to articulate the entity's commitment to identifying, managing, and mitigating AML/CTF risks. The RAS is vital for regulated entities for several reasons:

- **Compliance with Regulatory Standards:**
  The RAS ensures adherence to CSSF regulations, specifically the Law of 12 November 2004, as amended, and Guideline CSSF 12/552. Compliance with these standards is essential to avoid legal and regulatory penalties.
- **Framework for Decision-Making:**
  By defining acceptable levels of risk, the RAS provides a framework for decision-making. It guides management and staff in conducting business activities safely and compliantly.
- **Enhancing Reputation:**
  A well-defined RAS helps maintain the entity's reputation by demonstrating a commitment to high standards of integrity and compliance. This is crucial for building trust with customers, regulators, and other key stakeholders.
- **Operational Excellence:**
  The RAS fosters an environment of regulatory compliance and operational excellence, ensuring continuous staff training, regular internal audits, and updates on regulatory changes.

02. REGULATORY FRAMEWORK AND STRUCTURE OF A RAS

The CSSF mandates compliance with the Law of 12 November 2004, as amended, on the fight against money laundering and terrorist financing. Guideline CSSF 12/552 provides advisories on governance, risk management, and internal controls. The 6th Anti-Money Laundering Directive (AMLD6) further augments the regulatory landscape.

We see the regulator places emphasis on the following areas regarding the RAS:

- **Customer Due Diligence (CDD)**
- **Transaction Monitoring**
- **Governance and Oversight**
- **Regulatory Reporting**
- **Staff Training and Awareness**

Each entity must and can define and describe their risk tolerance levels, being their own risk appetite towards AML-related risks. For AML/CTF specifically, the RAS should focus on the risks and factors associated with these areas. The key categories and factors typically include:

- **Client Risk:**
  Risks associated with different types of clients, including their background, industry, and geographical location. High-risk clients such as politically exposed persons (PEPs), clients from high-risk countries, and clients with complex ownership structures.
- **Transaction Risk:**
  Risks related to the nature, volume, and value of transactions. Unusual or suspicious transactions, high-value cash transactions, and transactions with high-risk jurisdictions.

02.

REGULATORY FRAMEWORK AND STRUCTURE OF A RAS

- **Geographical Risk:**
  Risks arising from business activities in certain jurisdictions. Countries with weak AML/CTF regimes, high incidence of corruption, and high levels of organized crime.
- **Product/Service Risk:**
  Risks inherent in the provision of certain products and services. Private banking, correspondent banking, trade finance, and services facilitating anonymity.
- **Distribution/Channel Risk:**
  Risks associated with the delivery channels used to provide products and services. Non-face-to-face interactions, use of intermediaries, digital channels.

The RAS is a key governance document, which evidences the "tone for the top" and the rules to be understood and applied throughout the entity. It is usually structured in 3 parts:

1. **Prohibited elements (i.e all risks factors, nature or threshold that an entity is not willing or capable to mitigate)**
2. **Target/Core elements (i.e. the main activities, client, geographies, etc. an entity is willing or capable to accept) , and**
3. **Escalation process/mechanisms (i.e. the rules by which all other risk factors are assessed and how the acceptance/refusal is decided and documented).**

03. OPERATIONAL CHALLENGES IN THE BANKING INDUSTRY

Keep it simple

To be useful such a framework must be operationalized. There are no point having lots of nice and detailed principles in a document if you cannot implement them and use them on a daily basis. It is a difficult exercise as you want to embrace in one unique document all possible situations. This a trap to avoid as you will never be able to enclose all cases your institution might be facing now or in the future. A good way to ensure the effectiveness of such a tool is to test it on real cases ahead of its finalization with business representatives.

Expert judgment

The AML RAS aims to help each and every employee in its daily life as a decision support tool. It will not prevent them to reflect on their files developing a proper opinion with arguments. It does not replace but complements the professional judgment of experts.

Data

An AML RAS shall encompass Key Risk Indicators enabling the possibility to define limits and more importantly to observe trends. It shall enable the Management of a financial institution to keep an alignment with its business objectives. Correct and up-to-date data is therefore the cornerstone of such a management dashboard.

If an institution decides not to accept clients that have made their wealth in specific risky industries, the right information needs to be captured in the tooling solutions both at the onboarding phase but also during the client life cycle notably at the occasion of the periodical review. The accurate and precise data must then be loaded within the right field, and updated whenever required.

03. OPERATIONAL CHALLENGES IN THE BANKING INDUSTRY

Common understanding

Another key to succeed in such an exercise is the right and common understanding of the AML RAS across the organization at all levels. A clear glossary is certainly one of its key components. Additionally, organizing trainings to the staff from the 3 lines of defense is a MUST. These awareness sessions must be conducted with a lot of pedagogy, based on examples and be reiterated over time.

Focus on what matters

It is also a lever for all relevant parties to focus on what matters. There is no reason for a business developer to target a prospect residing in a country that is not in line with the strategy approved by the Board of Directors. Beside generating risks the institution does not want to be exposed to, these practices generate a waste of time, and lots of frustration with incessant back and forth between business and compliance.

Limited resources and making choices

While being busy with files that are not fitting with a clear strategy, institutions are burning rare a precious resources that are consequently not available anymore to support a sustainable and healthy business growth.
Beside an organization cannot pretend mastering all types of clients, countries, activities, products and services.
Defining a Risk Appetite means making choices in a twofold way. The Management Body decides positively the risks he is ready to take and the ones he does not want to take. And obviously the resources need to be allocated to the ones endorsed by the Board of Directors.

Clear escalation process

It does not mean that no exception is tolerated but that if such a situation occurs it will follow a clear process. Such an exception would be accepted or not in a transparent way and with all stakeholders well informed of the related risks.

04.

EVOLUTION OVER TIME

Defining a clear and easy reading AML RAS is not a simple task, and reviewing it on a regular basis is certainly not an option. This is not only true to ensure compliance with the new regulation but also to take into account the lessons learnt from the last months or year (e.g.: what was not well understood, not well phrased, what was missing), the feed-back received from your external or internal auditors, the authorities, your clients, or business partners. And more importantly it will also reflect the evolution the organization's own choices.

05.

NEED AND POSSIBILITIES FOR DATA AND RAS INDICATORS DASHBOARD

Managing Anti-Money Laundering risk appetite requires a structured approach to collecting, storing, and analyzing key risk indicators (KRIs). A well-designed AML key performance indicators (KPIs) repository and dashboard will enable banks (but not only) to monitor risk exposure, detect early warning signs, and demonstrate compliance to the regulator.

06. DEFINING AML-SPECIFIC INDICATORS

Building an effective repository starts by identifying indicators that align with the bank's AML risk appetite statement. These should reflect dimensions such as customer risk, transaction risk, monitoring effectiveness, and regulatory compliance.

The diagram below shows a non-exhaustive view of typical indicators a bank could use :

Customer Risk Indicators	Transaction Screening & Monitoring Indicators	AML Compliance and Investigation Efficiency	Operational Effectiveness and Training
• **Percentage of High-Risk Customers:** Proportion of customers flagged as high-risk based on Enhanced Due Diligence (EDD). • **Geographical Risk Exposure:** Percentage of customers from high-risk jurisdictions (as per country risk, FATF, etc.). • **Politically Exposed Persons (PEPs) Ratio:** Number of PEPs as a percentage of total customers, also showing sub-classification with PEP degree and/or materiality. • **Adverse Media Exposure**: Number of customers or accounts with adverse media exposure.	• **Suspicious Activity & Transaction Reports (SARs / STRs) Filed:** Number and percentage of transactions escalated to regulatory authorities. • **Alerts Generated:** Total number of transaction screening & monitoring alerts triggered by the systems. • **False Positive Rate**: Percentage of alerts dismissed after investigation (with sub-classification (e.g., type of payment, type of alert, investigation tag, etc.).	• **Average Investigation Time for AML Alerts:** Time taken to review and resolve an alert. • **Backlog of AML Investigations:** Number of unresolved AML cases beyond the defined threshold. • **Regulatory Reporting Timeliness:** Percentage of STRs submitted on time.	• **AML / compliance staff training completion rate:** Percentage of AML team members who completed training in the last 12 months. • **System Uptime for AML/CTF screening and monitoring tools**: Availability and performance of AML/CTF detection systems.
• **Exceptions** • **Approved exceptions**			

07. BUILDING THE AML KPI REPOSITORY

Building a centralized RAS dashboard usually requires to go through several steps:

- **Select a central platform :**
  use a data warehouse and ensure it integrates with transaction screening/ monitoring systems, KYC solutions, and case management tools.
- **Define data sources and import processes :**
  identify data sources (e.g., core banking systems, compliance databases, third-party risk providers, etc.) and automate data extraction and homogeni-zation to feed the central repository (e.g., via standard ETL and/or Genera-tive AI).
- **Ensure data quality and homogeneity :**
  implement data check and validation rules to detect anomalies and stand-ardize KPIs across business units.
- **Structure the repository with specific data models** by storing KPIs at different levels, e.g., customer, transaction, operational, etc.

08. MAINTAINING THE REPOSITORY

Once delivered, the repository (and related dashboards) requires continuous monitoring, updates, and alignment with evolving AML/CTF risks and regulations. Such maintenance can follow few best practices:

- **Automate data refreshes:** ensure real-time or periodic updates (via batch or API integrations) and monitor completeness and accuracy.
- **Regularly review KPIs relevance:** conduct regular reviews to assess whether current KPIs still align with the bank's risk appetite, update KPI thresholds based on new regulatory guidance and emerging risks (e.g., cryptocurrency transactions, trade-based money laundering, etc.).
- **Ensure auditability:** maintain detailed audit trails for all KPIs calculations and adjustments, provide access to internal audit, etc.

Last but not least, banks can leverage advanced analytics and AI-driven solutions to enhance AML/CTF KPI tracking and decision-making. Where KPIs granularity and refresh frequency is high, it is even possible to forecast AML/CTF risk trends based on past indicators combined with external risk factors.

A well-structured and regularly refreshed AML/CTF KPI repository helps banks efficiently monitor their AML/CTF risk appetite, detect financial crime threats, and ensure compliance to local regulatory framework.

09. CONCLUSION

Crafting a robust AML Risk Appetite Statement affirms a regulated entity's **commitment to compliance** and helps protect the **integrity of Luxembourg's financial system**. A well-structured and evolving RAS, supported by data and operational alignment, ensures institutions stay ahead of regulatory expectations while making informed and strategic risk-based decisions.

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