Finantsinspektsioon

Supervision policy of Finantsinspektsioon for countering money laundering and terrorist financing

Foreword

Considering the open nature of the Estonian economic and business environment, the general globalisation of the financial sector and the technical development of financial services as well as the opportunities arising therefrom (incl. the opportunity of financial intermediaries to conquer new markets), this open nature simultaneously brings risks where criminally acquired money may search for ways to penetrate the Estonian financial system or to use it for covert or transformational transactions. These conditions require financial intermediaries to exercise appropriate due diligence measures to prevent money laundering and terrorist financing, protecting thereby, among others, the reliability and integrity of the financial system.

The trustworthiness and integrity of the Estonian financial sector and economic space as a whole depends on all the links in the system and the system is only as strong in ensuring the lawful or regular functioning of the financial market as are all the links in the system.

In this policy document concerning financial supervision, Finantsinspektsioon explains:

(i) the procedure for countering money laundering and terrorist financing established in Estonia and the role and functions of Finantsinspektsioon in such (supervisory) system;

(ii) the strategic objective of Finantsinspektsioon based on risk-based supervision and the supervisory approach.

The purpose of this policy document is to assist entities that are subjects of financial supervision to adjust their activities and organisation in order to maintain the trustworthiness and transparency of the financial sector and business environment, preventing thereby the use of the financial system and economic space of the Republic of Estonia for money laundering and terrorist financing, and to comply with the objectives arising from legislation and meet expectations related to financial supervision. The advisory guidelines “Organisational solutions and preventive measures for credit and financial institutions to take against money laundering and terrorist financing” of Finantsinspektsioon form an integral part of this document.

Considering the above, this supervisory policy has been divided into the following sub-chapters.

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I Combating money laundering and terrorist financing

Pursuant to §§ 4 and 5 of the Money Laundering and Terrorist Financing Prevention Act (hereinafter the MLTFPA), the generalised terms and definitions are as follows:

1) **money laundering** means
   a. the conversion or transfer of property derived from criminal activity or property obtained instead of such property;
   b. the acquisition, possession or use of property derived from criminal activity or property obtained instead of such property;
   c. the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of, property derived from criminal activity or property obtained instead of such property;
2) **terrorist financing** means the financing and supporting of an act of terrorism and commissioning thereof within the meaning of § 237^3 of the Penal Code.

Prevention of money laundering and terrorist financing is a global fight against criminal activity by means of relevant measures. This fight can conditionally be divided into two categories: (i) imposition of public, i.e. so-called preventive, obligations on persons governed by private law, incl. on credit and financial institutions (establishment of the MLTFPA); (ii) criminalisation of money laundering and terrorist financing.

II Domestic and foreign institutions and authorities related to prevention of money laundering and terrorist financing

Below is a general list of the main and significant institutions and authorities, taking into account the purpose of this policy document and the authority that has drawn it up (Finantsinspektsioon) as well as the potential points of contact of its supervision subjects with respective authorities and institutions. The list is non-exhaustive both in the national and international sense.

Ministry of Finance

The Ministry of Finance as a responsible ministry coordinates the development of legislation related to prevention of money laundering. In addition, the Ministry of Finance organises the work of the AML/CFT Committee whose functions include, among others, the preparation of the national risk assessment and the development of AML/CFT policies. The function of the AML/CFT Committee, consisting of the minister responsible for the field, the secretary general and the secretaries general of the ministries responsible for the related fields, representatives of the Financial Intelligence Unit, Eesti Pank and Finantsinspektsioon, and representatives of other relevant bodies and governmental authorities, is to pursue national cooperation in AML/CFT and in countering proliferation.

Ministry of Foreign Affairs

The function of the Ministry of Foreign Affairs is to coordinate policies related to international sanctions. The Ministry of Foreign Affairs is required to notify those who implement the sanctions of changes in sanctions regimes or establishment of a new regime. When communicating with the private sector, the role of the Ministry of Foreign Affairs is to provide assistance in interpreting specific provisions and court decisions, refer to correct documents and help to find implementing guidelines and instructions. The Ministry of Foreign Affairs cannot intervene in the process of implementing specific sanctions or has no competence arising from law to elaborate on the details of specific transactions or advise those who implement the sanctions in concluding transactions (incl. credit institutions, defence industry, technology, exporters, but also authorities performing public functions, e.g. the police, customs, etc.). Each entity related to the implementation of a sanction, incl. credit and financial institutions, is responsible for the timely application of relevant measures.

Financial Intelligence Unit

The Financial Intelligence Unit (hereinafter the *FIU*) is an independent structural unit of the Police and Border Guard Board whose main duties are gathering, registration, processing and analysis of information referring to money laundering and terrorist financing (i.e. reports and information submitted by all the entities required to comply with the law), as well as tracing of criminal proceeds and strategic analysis that covers the risks, threats, trends and ways of operation of money laundering and terrorist financing. In certain cases, the Financial Intelligence Unit also performs the duties of an investigative body.

The FIU verifies whether the data submitted to it is important for countering, identifying or pre-trial investigation of money laundering, related criminal offences and terrorist financing. The FIU analyses and verifies information about suspicions of money laundering and terrorist financing, takes measures for preservation of property where necessary and immediately forwards materials to the competent authorities (e.g. Prosecutor's Office) upon identification of elements of a criminal offence.

The FIU also has supervisory functions. The FIU exercises supervision over compliance with the requirements of the MLTFPA and legislation adopted on the basis thereof with regard to the obliged entities required to comply with the MLTFPA that are not subject to the supervision by Finantsinspektsioon, the Estonian Bar Association (attorneys) or the Ministry of Justice (notaries). The FIU also issues authorisations to its supervision subjects.

In addition, the FIU has a duty to exercise state supervision over compliance with the International Sanctions Act (incl. financial sanctions). In connection with this obligation, the FIU shall publish the information about the imposition, amendment or termination of international financial sanctions or shall make it available on its webpage.

Prosecutor's Office, Police and Border Guard Board, Estonian Internal Security Service, court

In the system of money laundering and terrorist financing prevention, these are authorities that hold the right in criminal proceedings by having the obligation to conduct criminal proceedings if facts referring to a criminal offence become evident (incl. in the role of an investigative body) and by having the right to perform (pre-trial) acts related to criminal proceedings. The functions of the Estonian Internal Security Service are mostly related to terrorist financing prevention. Thus, the above authorities are competent to conduct proceedings on money laundering criminal offences and decide on conviction for criminal offences (court).

Finantsinspektsioon

Finantsinspektsioon exercises supervision over compliance with the requirements of the MLTFPA and legislation adopted on the basis thereof by credit institutions and financial institutions that are subject to its supervision under the Financial Supervision Authority Act (hereinafter the *FSAA*) and in accordance with the legislation of the European Union. A more detailed treatment of the functions of Finantsinspektsioon is set out below in this policy document.

FATF

The Financial Action Task Force (hereinafter the *FATF*) is an inter-governmental organisation developing standards (recommendations) and methods for combating money laundering and terrorist financing. Countries being members of the FATF as well as of regional organisations (incl. MONEYVAL) are evaluated on the basis of the methodology developed by the FATF. The FATF is therefore a policy-making organisation in the field of combating money laundering and terrorist financing and the standards developed by the FATF are treated as generally recognised international principles, considering that the FATF recommendations have been transposed into Estonian law through the relevant legislation of the European Union (directives and regulations). The FATF carries out regular reviews in its member countries concerning compliance with the FATF standards and draws up the relevant public reports.

MONEYVAL

The Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (hereinafter *MONEYVAL*) is a permanent regional monitoring committee of experts at the Council of Europe entrusted with the task of assessing compliance of countries with the international principles (the FATF recommendations) of countering money laundering and terrorist financing and the effectiveness of measures taken by the countries. MONEYVAL carries out regular reviews in its member states (with some exceptions those who, for example, are not members of the FATF) and does this on the basis of the relevant FATF methodology that the FATF itself uses as a basis for evaluation of its member countries. As a result of the evaluation, MONEYVAL draws up a public report and submits recommendations and proposals to countries for improvement and intensification of measures to be taken. MONEYVAL also evaluates the compliance of the systems of the Republic of Estonia with the FATF standards.

III Finantsinspektsioon as a state financial supervision authority

The circle of subjects of financial supervision has been determined

Finantsinspektsioon is a state financial supervision authority exercising supervision only over the subjects of financial supervision and over the activities provided for in the FSAA, the Credit Institutions Act, the Creditors and Credit Intermediaries Act, the Insurance Activities Act, the Investment Funds Act, the Funded Pensions Act, the Securities Market Act, the Motor Third Party Liability Insurance Act, the Payment Institutions and E-money Institutions Act and the Securities Register Maintenance Act as well as in legislation established on the basis thereof (subsection 2 (1) of the FSAA).

The following subjects of financial supervision exercised by Finantsinspektsioon are required to comply with the requirements of the MLTFPA in their economic and professional activities (within the meaning of the MLTFPA and hereinafter also obliged entities):

- credit institutions;
- creditors and credit intermediaries;
- life insurance undertakings;
- life insurance brokers;
- investment firms;
- payment institutions;
- e-money institutions;
- fund management companies;
- a central securities depository.

More than 100 financial intermediaries are subject to the financial supervision exercised by Finantsinspektsioon for the purpose of countering money laundering and terrorist financing.

General objectives of financial supervision

Financial supervision is conducted in order to enhance the stability, reliability, transparency and efficiency of the financial sector, to reduce systemic risks and to promote prevention of the abuse of the financial sector for criminal purposes, with a view to protecting the interests of customers and investors by safeguarding their financial resources, and thereby supporting the stability of the Estonian monetary system (subsection 3 (1) of the FSAA).

Finantsinspektsioon operates pursuant to legislation and in a transparent and risk-based manner

Finantsinspektsioon shall operate pursuant to legislation and the internationally recognised principles relating to financial supervision and shall act openly and transparently and apply the principles of sound administration (subsection 5 (1) of the FSAA). The frequency of supervisory activities of Finantsinspektsioon and the methodology applied shall take account of the size of the subject of financial supervision, the effect of its activity

on the financial system as well as the nature, scope and level of complexity of the activity, based on the principle of proportionality /.../ (subsection 5 (2) of the FSAA).

The function of Finantsinspektsioon includes the area of money laundering and terrorist financing prevention

The financial supervision exercised by Finantsinspektsioon includes, within the competence assigned to it, supervision over due diligence measures applied for the purpose of money laundering and terrorist financing prevention.

III.1 Role of Finantsinspektsioon in prevention of money laundering and terrorist financing

Credit and financial institutions (financial intermediaries) are systemically important parties in ensuring the circulation of funds and, thereby, the integrity and reliability of the financial system, and this is the reason why the MLTFPA imposes public obligations, i.e. so-called due diligence measures, on them on the basis of a social agreement. By implementation of such preventive measures, they are seen as a crucial "protective layer" in the system of prevention of money laundering and terrorist financing and in achieving important national objectives – to prevent the use of the financial system and economic space of Estonia for money laundering and terrorist financing. This is based both on internationally recognised FATF recommendations as well as on relevant legal sources of the European Union (primarily Directive (EU) 2018/843 and Directive (EU) 2015/849 of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and Regulation (EU) 2015/847 of the European Parliament and of the Council on information accompanying transfers of funds).

Financial intermediaries consume benefits received from the regulatory environment, which are based on the reliability and smooth functioning of the financial sector and the business environment in general. Thus, the corresponding regulation and obligations imposed thereby on financial intermediaries also serve the interests of financial intermediaries (incl. the general interests of investors and depositors who are their customers, etc.), which, in turn, leads to the collective responsibility of the sector to prevent the abuse of the financial sector of Estonia for criminal purposes.

Finantsinspektsioon or financial intermediaries themselves have no competence of a body conducting pre-trial proceedings in matters of money laundering and terrorist financing or the right to act as a (pre-trial) investigative body in matters of money laundering and terrorist financing. Supervision in the field of prevention of money laundering and terrorist financing exercised in the course of financial supervision has been placed within the general context of the requirements applicable to financial supervision and financial sector, which primarily focuses on the appropriate organisational structure of financial intermediaries and, thereby, on the treatment of related risks (adequate assessment and management thereof), which, among other things, must contribute to the achievement of objectives set out in the MLTFPA.

The financial supervision exercised by Finantsinspektsioon in public interests in the area of prevention of money laundering and terrorist financing focuses on:

(i) the reduction of systemic risks in the financial sector to minimise the possibility of money laundering and terrorist financing through Estonian financial intermediaries and;

(ii) the organisation of financial intermediaries and the compliance thereof with relevant requirements and the resilience thereof in managing and mitigating risks;

(iii) the guarantee of capacity to comply with (due) diligence imposed on financial intermediaries under the MLTFPA, incl. (i) the capacity to identify persons (their ultimate beneficial owners) prior to the establishment of a business relationship, ensure the understanding of the nature of the customer's business and the continuing monitoring thereof and (ii) the capacity to refuse to establish a business relationship in the cases provided by legislation or decide the cancellation thereof, where necessary, and (iii) the capacity to comply with the obligation to report to the FIU on any suspicious or unusual transactions to enable the FIU to perform its function in the prevention of money laundering.

The FIU is competent to exercise supervision over compliance with the International Sanctions Act (incl. financial sanctions).

III.2 Risk-based supervision by Finantsinspektsioon

Finantsinspektsioon exercises risk-based supervision by collecting information about specific financial intermediaries from supervisory reporting and other sources and assessing thereby the general risk background in the financial sector. Finantsinspektsioon conducts internal risk assessments in respect of financial intermediaries. When exchanging information, Finantsinspektsioon also cooperates with other supervisory authorities and with authorities and institutions engaged in the prevention of money laundering and terrorist financing.

The creation of the risk assessment may be affected by various risk indicators. On one side, the risks affecting the subject, incl. the general risk appetite of the financial intermediary, the specific features or risk level of services, products or business model provided and the placement of such indicators in the financial system as a whole (e.g. activities in the higher-risk customer segment, high-risk jurisdictions, etc.), deviations in the revenue base of financial intermediaries, connection to money laundering and terrorist financing or covert or transformational cases of funds indicating to it, etc., are taken into account. On the other hand, the vulnerability of the financial intermediary, among others, to the aforementioned risks, incl. the potential inadequacy of the organisation and system and protection measures, is considered.

We primarily target our activities to inspections of such financial intermediaries in whose case we see a higher risk of money laundering and/or potential or more probable vulnerability to such risk.

Finantsinspektsioon selects such supervisory measure to be applied that Finantsinspektsioon considers the most effective and proportionate in order to reduce the risk of materialisation of money laundering and terrorist financing with regard to a specific subject of supervision. Such measures may include, individually or in combination with other measures, for example, an on-site or remote inspection, issue of a precept for compliance with the requirements arising from law (incl. for restrictions on transactions), declaration of a manager or owner as unsuitable, restriction on the voting right of the owner, consideration of the risks through the establishment of additional capital requirements, imposition of a fine or the revocation of an authorisation, as well as other rights arising from legislation.

III.3 Effective strategy of Finantsinspektsioon

The important priorities of financial supervision for future periods are determined in the strategy of Finantsinspektsioon. The preparation of the strategy is preceded by the assessment of risks. Pursuant to clause 7 (2) 1) of the FSAA, the operating strategy of Finantsinspektsioon shall be approved by the supervisory board of Finantsinspektsioon.

According to the effective strategy of Finantsinspektsioon, the supervision over the prevention of money laundering and terrorist financing is an important strategic choice for Finantsinspektsioon. The strategy is published on the website of Finantsinspektsioon.

The main purpose of the MLTFPA is, by increasing the trustworthiness and transparency of the business environment, to prevent the use of the financial system and economic space of the Republic of Estonia for money laundering and terrorist financing (§ 1 of the MLTFPA); in the event of the FSAA, financial supervision is conducted, among others, in order to /.../ enhance the reliability and transparency of the financial sector and prevent the abuse of the financial sector for criminal purposes (subsection 3 (1) of the FSAA).

To explain the strategy, Finantsinspektsioon substantiates the specification of the risks relating to serving customers with a higher risk (i.e. the risk that is higher than usual) by the fact that the provision of services to such customers undoubtedly requires enhanced due diligence from credit and financial institutions to achieve the purpose of reliability and transparency in the part that renders it possible to know the conditions prevailing

on the target market of their customers (business environment), incl. business rules and risks arising therefrom. The distance-based business model often entailed with such customers and establishment of business relationships with customers present a considerably greater challenge for the organisation of the financial intermediary to identify circumstances for the purpose of money laundering and terrorist financing prevention, which help to assess, among others, the identification of the beneficial owner, obtain information about the business relationship and purpose and nature of the transaction, and in such an event the constant monitoring of the business relationship is also difficult.

According to the risk assessments of Finantsinspektsioon, the higher risk of money laundering has arisen in the financial sector through various cases and primarily in the area of non-residents (with a risk higher than usual) (incl. in a situation where at least one beneficial owner of the customer is a non-resident) operating, among others, in high-risk jurisdictions. The cases include, inter alia, money laundering known on the international scale as well as the general cases referring to covert or transformational activities of assets, and the circumstances established by Finantsinspektsioon during inspections and generally known circumstance related to customers corresponding to the characteristics of a higher risk.

The risk and, thereby, the due diligence expected is also higher for credit and financial institutions that have or plan business relationships with payment institutions or other people and platforms (e.g. environments trading in cryptocurrency, etc.) that, in turn, serve their customers who may also correspond to the characteristics of higher-risk customers, incl. who are located or operate in a high-risk jurisdiction.

III.4 Important aspects assessed by Finantsinspektsioon in the course of supervision over the organisation of prevention of money laundering and terrorist financing

Finantsinspektsioon draws attention to some important aspects that the financial intermediary that is an obliged entity under the MLTFPA must keep in mind on the whole when building up an organisation of prevention of money laundering and terrorist financing and on which the supervision by Finantsinspektsioon in the field of money laundering is based to a considerable extent.[1]

- General requirements for the organisation

An obliged entity must ensure that the organisational approach continues to be in proportion to the nature, scope and level of complexity of their activities (incl. the customer segment in which the obliged entity operates) and complies with the size and nature of risks threatening them and the risk appetite established by them. Managers of the obliged entity ensure that they and their employees act in the conditions ensuring awareness of the requirements for the prevention of money laundering and terrorist financing as well as of the relevant risks and threats and monitoring of such risks and threats, and that such culture of compliance is also fostered in reality.

- Determination of risk appetite

An obliged entity must have determined the risk appetite (risk tolerance). Risk appetite means the total of the exposure level and types of the obliged entity which the obliged entity is prepared to assume for the purpose of attainment of its business goals and which is established by the senior management of the obliged entity in writing. The determination of the risk appetite is an important prerequisite for ensuring the resilience of an organisation to the risk assumed. Upon application of the risk appetite, the obliged entity determines at least the characteristics of the persons with whom the obliged entity wishes to avoid business relationships and with regard to which the obliged entity applies enhanced due diligence measures, including the obliged entity assesses risks related to such persons and determines appropriate measures for mitigating these risks, incl. the conditions and nature of the organisation required therefor (size, separation of functions, etc.).

[1] The list is general and is not exhaustive. The requirements for an organisation may be regulated differently in legislation governing the activities of obliged entities. In terms of imperative requirements arising from legislation, obliged entities are required to follow the requirements arising from legislation.

- Functioning of risk management systems

An obliged entity ensures that the procedures for identification, measurement, management, constant monitoring and reporting of risks inside the organisation have been established which are adequate and proportional considering the nature, scope and level of complexity of the activities of the obliged entity. Managers are regularly informed of risks in the field of prevention of money laundering and terrorist financing and such approach to risks arises from the internal documentation of the obliged entity.

- Determination of areas of responsibility and transparency

The structure of an obliged entity must be transparent and with clearly delineated areas of responsibility and ensure the avoidance of conflicts of interests related to the establishment of customer relationships (assumption of risks) and mitigation of related risks (risk management). Where the obliged entity has more than one member of the management board, the obliged entity appoints the member(s) of the management board who is (are) responsible for compliance with the requirements for prevention of money laundering and terrorist financing.

- Suitability of responsible member of the management board

Only a person who has the appropriate knowledge, skills, experience and education on money laundering and terrorist financing prevention, is professionally suitable and has an impeccable business reputation may be elected or appointed the responsible member of the management board. The responsible member of the management board is constantly aware of the risks that affect the obliged entity and of the organisational approach that is capable of mitigating specific risks. A manager must demonstrate sufficient professionalism, integrity, accuracy and diligence in their activities to ensure the compliance with the requirements for prevention of money laundering and terrorist financing.

- Functioning of compliance and internal control (incl. compliance officer of the FIU)

An obliged entity implements an appropriate compliance and internal control system for the prevention of money laundering and terrorist financing. Employees related to compliance are provided with the required means and appropriate independence to perform their duties. The obliged entity avoids an approach that may entail a conflict due to the nature of the duties (assumption of risks *vs.* assessment of risks).

- Functioning of internal rules and technical approaches

An obliged entity formalises internal rules in writing and these must be up-to-date and easily identifiable, clear and transparent in their combined effect. Internal rules comply with the actual activities of the obliged entity and provide employees with unambiguous explanations of models of conduct in different situations. Internal rules are unique for each company, and they must take into account the nature, scope and level of complexity of the activities of the applicant and ensure compliance with the requirements for prevention of money laundering and terrorist financing.

In terms of compliance with the requirements for prevention of money laundering and terrorist financing, the internal rules and technical approaches applied (algorithms, etc.) are of significant importance and address the functioning of the organisation in complying with due diligence arising from the MLTFPA and obligation to report to the FIU.

- Training systems

An obliged person must constantly and based on necessity organise training (training upon commencement of employment and during the employment relationship), which provides the relevant employees with an overview of internal rules applied, modern methods of committing money laundering and terrorist financing and the related risks, how to recognise acts related to possible money laundering or terrorist financing and instructions for acting in such situations.

- Due diligence

An obliged entity must know their customer and must be certain that they understand the transactions concluded by the customer. When establishing a business relationship, the obliged entity collects information about the customer in order to make sure that the overview of the customer and customer profile is sufficient and the reason why the specific service is needed is known. The obliged entity will obtain inner conviction during the business relationship that the transactions to be conducted in the course of the business relationship comply with the knowledge obtained during the establishment of the business relationship, i.e. with the information previously known about the customer.

The obliged entity identifies and pays more attention to the activities of the customer or circumstances that refer to a criminal activity, money laundering or terrorist financing or that are likely to be associated with money laundering or terrorist financing, including too complicated, high-value and unusual transactions and transaction patterns. The obliged entity must be sure that they know the customer, that the transactions of the customer are not fictitious and are actually concluded, that the model of conduct of the customer is logical and justified in the economic and legal sense and that the conduct is characteristic of the specific features of the business in question. In a nutshell, a credit and financial institution must be convinced that the customer is or the transactions are transparent. To this end, the obliged entity must, among others, consider the money laundering or terrorist financing risks and methods specific to Estonia set out in annexes to the advisory guidelines of Finantsinspektsioon. In the event of the occurrence of the characteristics specified above, the obliged entity is constantly prepared to explain the reasons why the business relationship has been established with the customer or why the business relationship is continued.

A credit or financial institution takes relevant measures arising from law if the customer and their activities are not transparent, are associated with persons whose activities are not understandable or are unusual in any other manner, incl. makes a decision on reporting to the FIU.

- Relations with third parties (outsourcing) and reliance

If an obliged entity has outsourced a duty of money laundering or terrorist financing prevention to a third party or relies on another entity in the application of due diligence measures, the obliged entity ensures that such outsourcing or reliance is preceded by a proper audit and the obliged entity makes sure that the other entity has the capacity to perform such a duty.

IV Further information

In the event of any further questions, the following contact details can be used to address Finantsinspektsioon.

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