

POSITION PAPER



Anti Money Laundering and Combat Financing Terrorism rules and the challenge of financial inclusion

WSBI experience and proposals to FATF

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WSBI

ANTI MONEY LAUNDERING AND COMBAT FINANCING TERRORISM RULES AND THE CHALLENGE OF FINANCIAL INCLUSION

WSBI experience and proposals to FATF

Financial sector institutions in the developing world have expressed concerns regarding the constraints to financial inclusion resulting from the implementation of Anti Money Laundering (AML) and Combating the Financing of Terrorism (CFT) rules. Unintended and undesirable consequences of AML/CFT requirements, related in particular to the compliance with the Customer Due Diligence (CDD) process, impair access of low income people to formal financial services, especially in developing and emerging economies.

As the global voice of the savings and retail banking industry worldwide, the World Savings Banks Institute (WSBI) fully understands the objectives of the AML/CFT rules and the need to define internationally applicable standards. WSBI is convinced that financial inclusion and AML/CFT rules pursue mutually supportive and complementary objectives: the definition of measures which enable more citizens to use formal financial services increase the reach and the effectiveness of AML/CFT controls. WSBI therefore supports the development of well balanced and proportionate frameworks, which reconcile the objectives of encouraging the provision of formal financial services to large parts of the population, including to the low-income categories, and designing efficient and effective AML/CFT provisions, in compliance with the FATF Recommendations.

With this supportive approach in mind, WSBI would like to make some proposals to ensure that the FATF Recommendations fulfill their goals of efficiently combating money laundering and terrorism financing, without challenging the access to finance of the vulnerable groups of clients, particularly in developing countries. It is the hope that through joint efforts with other actors interested in the debate, such as CGAP¹ and the Alliance for Financial Inclusion², the objective of reconciling financial integrity and inclusion can successfully be met.

1. AML/CFT CHALLENGES FOR WSBI MEMBERS IN DEVELOPING COUNTRIES

For WSBI members, the main financial inclusion challenge linked to the implementation of the AML/CFT rules is the Customer Due Diligence requirements (CDD), as stated in FATF Recommendation 5³. It involves gathering information regarding the identification and the verification of the identities of prospective clients. The objective is to ensure that institutions know with whom they are doing business and thereby prevent that ill-intentioned persons or organisations abuse their services.

In a number of developing countries, the way people are identified (name, address etc) makes full compliance with the Recommendation requirement a burdensome and costly process. Those financially vulnerable people, who form a significant part of the (potential) clientele of

¹ Jennifer Isern and Louis de Koker. 2009. "AML/CFT: Strengthening Financial Inclusion and Integrity." Focus Note 56. Washington, D.C.: CGAP <http://www.cgap.org/p/site/c/template.rc/1.9.37862/>

² <http://www.afi-global.net/gpf09/agenda.htm>

³ http://www.fatf-gafi.org/document/28/0,3343,en_32250379_32236930_33658140_1_1_1_1,00.html

savings banks, often lack proper identification documents. A survey amongst WSBI members highlighted a number of practical problems⁴:

- ✓ obligation to get information on the occupation of the clients and on the use of the funds leads to a heavy procedure for each of the transactions;
- ✓ lack of proper identification documents (ID, Passport);
- ✓ lack of official proof of income and residence address. For instance, self-employed rural farmers would not be able to produce proof of income while poor living in rural areas and informal accommodations will not be able to justify their residence address;
- ✓ lack of appreciation by the unbanked of the need to supply the compliance information;
- ✓ customers do have the requisite documentation, but due to the lack of information they do not have them on their person when going to the bank to open accounts and would necessarily not be served. These prospective customers might be coming from places quite distant from the branches, and would obviously find it costly in terms of time and money to go back to the bank to open accounts.

In addition, the obligation for financial institutions to keep records on the identification data obtained through the CDD procedure, for at least 5 years (Recommendation 10⁵) proves burdensome and not justified in a majority of cases.

Some WSBI member banks may also face reputation risks resulting into a commercial challenge, since these CDD requirements are conflicting with their mandate to serve unbanked and under-banked people.

Lesotho PostBank: The impact of the introduction of AML/CFT requirements was measured by the sales comparison between the years 2005, when the bank started operating, and 2008, when the CDD/KYC process was implemented: LPB sales have been on an upward trend pre-KYC implementation, but dropped dramatically in 2008 when KYC was implemented. Sales decline could have been caused by economic pressures such as increased cost of living, but this decline would have been gradual and not sudden. Overall, the savings book's new accounts recorded an average of 1,006 customers per month for 2008, as opposed to 1,700 average numbers of customers per month in 2007. Obviously the most vulnerable people are often those who lack the prescribed documents and too stringent requirements often turn them down from embracing formal banking services.

2. IMPACT ON THE DEVELOPMENT OF INCLUSIVE FINANCIAL SECTORS

AML/CFT requirements place obligations on financial institutions that are expensive to meet (e.g. having compliance officers at different locations to verify day to day transactions⁶), more forcefully in developing countries. Mass-market financial institutions such as WSBI member banks, consider that these regulations are not adapted to the local context and can be disproportionate in terms of costs and administrative burden, particularly when applied to “small” accounts and when they have to be repeated for each of the transactions performed.

⁴ As reported for example by the HFC Bank Ltd, Ghana; Caisse d'Epargne de Madagascar; Bank Simpanan Nasional, Malaysia; Philippine Postal Savings Bank; PostBank Uganda; Postbank South Africa or Lesotho PostBank

⁵ http://www.fatf-gafi.org/document/28/0,3343,en_32250379_32236930_33658140_1_1_1_1,00.html

⁶ As reported for example by PostBank Uganda

To the extent that such expenses are reflected in increased costs of services, a financial barrier to access is raised. Furthermore, these costs can lead to financial institutions withdrawing from client segments which are consequently deprived of any access to financial services.

It is also important to tackle this issue in order to accompany the development of innovative ways of banking, particularly suited to the needs of low income people in developing economies. In this respect, branchless banking has proved very promising, both through partnerships between banks and retail outlets (“agent banking”) or through technologies such as mobile phones. The positive impact of these new ways of banking should not be weakened by regulatory obstacles raised by AML/CFT requirements.

3. EXAMPLES OF MITIGATING RESPONSES DEVELOPED BY WSBI MEMBERS

Members have launched initiatives to overcome the problems caused by identification requirements:

Ghana	HFC Bank Ltd	<ul style="list-style-type: none"> ✓ The bank accepts utility bills, tenancy agreement, house number as evidences of the residence or address of prospective clients.
Lesotho	PostBank	<ul style="list-style-type: none"> ✓ <i>Village Chiefs</i> are proposed as <i>points of verification</i> for people who wish to open accounts in rural areas at PostBank. Initially the Chiefs utilised their resources (stationery/ stamps) to authenticate prospective customers. Since, PostBank has designed a <i>form that customers fill and take to their village Chiefs for date stamping</i>, in compliance with regulatory prescriptions. ✓ Various radio stations have been used by PostBank to communicate the requirements upon opening accounts so that people going to the nearest village/town to open a bank account can take with them whatever documentation or certification needed.
Malaysia	Bank Simpanan Nasional	<ul style="list-style-type: none"> ✓ The bank accepts <i>birth certificates, passports</i> as means of identification for Malaysian citizens and <i>refugees’ cards, student cards, work permits and letters from college/ university</i> for non citizens. ✓ <i>Employee address</i> or any other address is accepted to justify a residential address. As for rural areas which do not have any information of residency or address, the bank requires a <i>postal address</i>, which is either a <i>communal post box or neighbor address</i>. ✓ Large scale initiatives are taken to inform the population about the requirements for opening accounts: communication (circulation of pamphlets, information notice at branch) or campaigns (visits to villages, rural schools).
Philippines	Postal Savings Bank	<ul style="list-style-type: none"> ✓ <i>Barangay Certification</i>, a certificate issued by the village master, is accepted as a proof of identification and residence. ✓ The bank accepts as other forms of identification: <i>passport, driver license, student ID, employment ID</i>, if such documents are <i>issued by official authorities of the Republic of Philippines, its subdivisions and instrumentalities, government owned and controlled bodies and private entities registered and supervised by the Central Bank (BSP), the Securities and Exchange Commission and the Insurance Commission</i>.
South Africa	Postbank	<ul style="list-style-type: none"> ✓ Postbank accepts any valid documents reflecting the customer’s address, for the identification of clients regulated outside the scope of the entry-level Mzansi accounts. These are: <i>utility bill; bank statement from another bank, recent lease or rental agreement; municipal rates & taxes</i>

		<i>invoice; retail account statement; telephone or cellular, telephone, account; valid television license; home loan statement from another financial institution; long/short-term insurance policy documents; motor vehicle registration documents; municipal councillor letter; corporate/governing body letter or statement; official employer letter for employees resident on company/institution premises; official university/technikon registration letter; tribal authority letter; or Affidavit or declaration.</i>
Uganda	PostBank	<ul style="list-style-type: none"> ✓ PostBank accepts <i>voters cards</i> which have a photograph, <i>utility bills, reference from known customers and local council letters</i>, as alternatives to official proofs of identification. ✓ The Bank has also categorised the clients into groups, such as <i>sole proprietors, partnerships, individuals, limited liability companies, Government departments, associations, clubs & trustees</i> and CDD requirements have been customized for each group.

4. RECOMMENDATIONS TO REMOVE THE CURRENT OBSTACLES

4.1. Promoting the use of the flexibility of FATF Recommendations

FATF Recommendations allow for flexibility in their implementation, so that national measures can be tailored to the local context. However, national authorities in developing countries do not always take advantage of this option. In their large majority, they tend to fully reproduce the international standard, designed for developed countries, in their national legislation. This approach negatively impacts, unintentionally though, the efforts made to financially include parts of the population, and contributes to their reluctance to use formal financial services.

However, a number of examples exist, such as Mexico or South Africa, which evidence that customization of AML/CFT Recommendations at country-level can respond to the need of low income prospective clients. Their approach is based on the perceived level of risk of transactions and of clients, and encompasses two complementary types of measures⁷:

4.1.1. The definition of a reduced CCD regime, where the risks are potentially low

The most commonly used criteria to define the transactions to which a simplified CDD process can be applied is the value, lower value meaning lower risk. Two other aspects can also be considered⁸:

- ✓ the cross-border element, regarded as entailing higher risk;
- ✓ the linkage of the transactions or institutions to the formal payment system, seen as holding a higher risk for the financial system than non-connected transactions or institutions.

⁷ Implementing FATF standards in developing countries and financial inclusion: Findings and guidelines, G:ENESIS, FIRST initiative, May 2008

http://www.cenfri.org/documents/AML/AML_CFT%20and%20Financial%20Inclusion.pdf

⁸ Implementing FATF standards in developing countries and financial inclusion: Findings and guidelines, G:ENESIS, FIRST initiative, May 2008

http://www.cenfri.org/documents/AML/AML_CFT%20and%20Financial%20Inclusion.pdf

On this basis,

- ✓ In *Mexico*, different sets of risk-sensitive regulations have been created for different financial services providers -commercial banks, popular loan and savings entities (“cajas”) etc- depending on the transactions they process and the clients they serve. A special regime has thus been enacted for banks with low-value accounts. Those are not required to open a client identification file for bank accounts if during any calendar month, the account has an average balance of less than USD 3,000 or if, during the course of the same month, accumulated deposits are less than the equivalent of USD 10,000. This approach has served to significantly limit the impact that the AML regime has had on access to financial services in Mexico. A recent reform distinguished between four types of cajas, depending on their asset and deposit base. Those with the more limited asset base are subject to less onerous AML/CFT requirements. In particular, they are required to have less sophisticated monitoring systems, which do not necessarily need to be electronic. It is to be hoped that the other three categories will be able to comply with the full set of rules applicable to them.

Another measure of application for the benefit of Mexican citizens, although not edicted by Mexican authorities, is the possibility for Mexican undocumented migrants in the US to use their Matrícula Consular card as an identity document. The Matrícula is accepted by American banks as a proof of identity for the opening of a bank account and for remittances purposes. This has facilitated larger remittances flows through formal channels, especially since banks accepting the card as an identity document were offered the incentive of opening banks counters in Mexican consular offices in the US.

- ✓ *South Africa* designed specific AML/CFT rules applicable to the Mzansi account, an entry-level bank account launched for the purpose of promoting financial inclusion countrywide. Institutions offering this product are dispensed with the need to obtain and verify a client’s residential address, in respect of accounts for which the balance does not exceed USD 3,300 and in which individual transactions do not exceed USD 660. The exemption also applies to single transactions below the threshold and money transfers within the Rand Common Monetary Area (CMA). By December 2008, more than 6 million accounts had been opened nationwide⁹.
- ✓ In *Malawi*, when a potential customer does not have the requisite documentation, a close relative (brother/sister) can submit his/her reference (passport details), in support of an application by the person who does not have the necessary documentation.

One of the main lessons to be learnt from these experiences is that the successful regulatory outcome requires a participatory approach between all stakeholders involved, and especially the regulators, the banking supervisors, the banking industry and the national authorities responsible for ID issues. The solutions proposed must be based on actual market research and thorough analysis of the needs and reality of the financially excluded on the domestic market. Besides, a step-by-step approach has often proved necessary, to best adjust the regulatory framework to a moving target and to take into account the evolution of the overall political and economic context (e.g. stronger mobilization against the development of terrorist groups in a number of countries).

⁹ http://www.finmark.org.za/documents/R_Mzansi_BFA.pdf

4.1.2. A sequenced implementation of the FATF set of Recommendations, across financial sectors, institutions and operations

The analysis of national AML/CFT frameworks in developing economies shows that a gradual implementation of the FATF Recommendations is another appropriate approach to efficiently reduce the negative impact on financial inclusion¹⁰. The idea is to apply differentiated levels of AML/CFT controls, starting with full implementation of the Recommendations for the sectors and transactions presenting the higher risks of money laundering and financing terrorism, and progressively applying a comprehensive regime, as capacities of the countries to properly identify and master the risks involved develops.

According to this approach, the G:ENESIS/First initiative study suggests distinguishing three successive phases, once the financial services sector regulation is in place and running, including the licensing of banks process and the reporting of their transactions to the supervisory authority (*Coverage step*):

- ✓ *Traceability of customers and transactions*: requires basic customer identification procedures (even though verification may be limited) and standardised record-keeping, accessible to the supervisors;
- ✓ *Profiling, verification and monitoring*: involves more extensive verification of customer identity, extended profiling of customers and the pro-active monitoring of transactions for AML/CFT purposes;
- ✓ *Advanced verification and interdiction*: the national identification system and capacity of financial institutions enable verification with high levels of integrity to be performed and suspicious individuals and transactions can be prevented from using the formal financial system.

4.2. The way forward

WSBI and its member banks stand ready to contribute to the FATF's, and other stakeholders', efforts to ensure a high degree of compliance with the AML/CFT Recommendations. With this objective in mind, they would propose cooperating with a view to:

- Raise awareness on the possibility offered to national authorities to flexibly implement the FATF Recommendations at national level. The benefits of taking full advantage of this opportunity should be actively promoted, possibly through:
 - ✓ Exchanges of experiences and best practices developed in some countries to overcome the difficulties identified, at the FATF Regional task forces and through case studies available from a web-based portal/database;
 - ✓ Dialogue in the framework of the FATF Consultative Group, whose objective is to provide private sector bodies representing the financial industry with the opportunity to raise issues with the FATF.
- Explore the opportunities to provide technical assistance to low capacity countries, where WSBI has members, enabling them to define minimum systems of anti money laundering;

¹⁰ Implementing FATF standards in developing countries and financial inclusion: Findings and guidelines, G:ENESIS, FIRST initiative, May 2008
http://www.cenfri.org/documents/AML/AML_CFT%20and%20Financial%20Inclusion.pdf

- Define guidelines for further progress regarding compliance with AML/CFT Recommendations in developing countries¹¹.

5. CONCLUSION

One needs to keep in mind that financial inclusion is a multi-dimensional challenge, of which AML/CFT requirements are an important aspect, but only one amongst many others. Solving the AML/CFT issue is not the magic wand towards fully inclusive financial sectors, but it is nevertheless a milestone towards building an enabling framework. Actions will still need to be developed in the fields of accessibility and affordability of financial services, design of adapted products for low income segments, banks' staff attitude, financial literacy etc.

The WSBI supports the development of well balanced and proportionate AML/CFT regulatory frameworks, which reconcile financial inclusion's objectives with the FATF Recommendations. In order to meet these goals, any national AML/CFT regime needs to be tailored to the domestic circumstances. In particular the level of development of the market, the financial culture, the structure and capacity of formal financial institutions but also the existence of a national infrastructure for the identification of the population, the specific exposure of the country to terrorist organizations or the cross-border movements of population have to be taken into account.

WSBI calls for the adaptation of the AML/CFT provisions at national level to avoid impairing financial inclusion.

¹¹ As an example, see the Guidelines defined in the framework of the FIRST Initiative project led by G:ENESIS http://www.cenfri.org/documents/AML/AML_CFT%20and%20Financial%20Inclusion.pdf



About WSBI – The Global Voice of Savings and Retail Banking

WSBI (World Savings Banks Institute) is one of the largest international banking associations and the only global representative of savings and retail banking. Founded in 1924, it represents savings and retail banks and associations thereof in 92 countries of the world (Asia-Pacific, the Americas, Africa and Europe – via ESG, the European Savings Banks Group). WSBI works closely with international financial institutions and donor agencies and facilitates the provision of access to financial sectors worldwide – be it in developing or developed regions. At the start of 2008, assets of member banks amounted to more than € 10,000 billion, with operations through more than 380,000 branches and outlets.

WSBI members are typically savings and *retail* banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their *region*. WSBI member banks have reinvested *responsibly* in their region for many decades and are one distinct benchmark for corporate social responsibility activities throughout the world.

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