

Derisking: Implications for AML/CFT Regime

Dakar, Senegal
August 2017

Topics

1. Concept of de-risking
2. Consistency of derisking with the FATF standards
3. Why some financial institutions de-risk
4. Is derisking an escape route for proper risk management?
5. Implications the emerging trend for AML/CFT

Programme

Session 6 – Derisking: Implications for AML/CFT Regime

New regulations, the cost of managing ML/TF risks, rising regulatory sanctions and enforcement actions are making it increasingly expensive for financial institutions, especially banks, in developed countries to do business with some banks /clients in developing countries, including those in West Africa, until they are able to prove that their AML/CFT programmes comply with international requirements.

This has led to the banks terminating or restricting their business relationships with individuals and entities from regions that are considered high-risk for money laundering and other financial crimes or clients that they consider to present an unacceptable level of risk to the institutions.

The session will discuss the concept of de-risking, why some financial institutions de-risk, and the risk of derisking. Overall, the session will provide international perspectives to the subject matter; discuss the consistency of this approach with the FATF standards, whether this practice is an escape route for proper risk management, and what implications this emerging trend has on the implementation of global AML/CFT regime.

References

- The FATF Recommendations, June 2012. International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation
- FATF Guidance, February 2013. Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion
- FATF Guidance, February 2013. National Money Laundering and Terrorist Financing Risk Assessment
- World Bank, 2013. Global Remittances Working Group. Barriers to access to Payment systems in sending countries and Proposed solutions. Special-Purpose Note
- Basel Committee, January 2014. Sound Management of Risks Related to Money Laundering and Financing of Terrorism
- World Bank, 2014. Emiko Todoroki, Wameek Noor, Kuntay Celik, and Anoma Kulathunga. Making Remittances Work - Balancing Financial Integrity and Inclusion
- World Bank, October 2015. Report on the G20 Survey On De-Risking Activities in the Remittance Market

References

- FATF REPORT, October 2015. Emerging Terrorist Financing Risks
- IMF, June 2016. Prepared by Michaela Erbenová, Yan Liu, Nadim Kyriakos-Saad, Alejandro López-Mejía, Giancarlo Gasha, Emmanuel Mathias, Mohamed Norat, Francisca Fernando, and Yasmin Almeida. The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action
- IMF/WORLD Bank 2016 Annual Meetings Small States Form Speech. Presented by The Honourable Audley Shaw CD, MP. Minister of Finance and the Public Service. Topic: Equitable Growth, Finance and Institutions. Sub-topic: De-Risking and Remittances in the Caribbean
- FATF Guidance for a Risk-based Approach, February 2016. Money or Value Transfer Services
- SWIFT, August 2016. Addressing the unintended consequences of de-risking – Focus on Africa
- FATF Guidance, October 2016. Correspondent Banking Services
- FSB, December 2016. FSB action plan to assess and address the decline in correspondent banking - End-2016 progress report and next steps

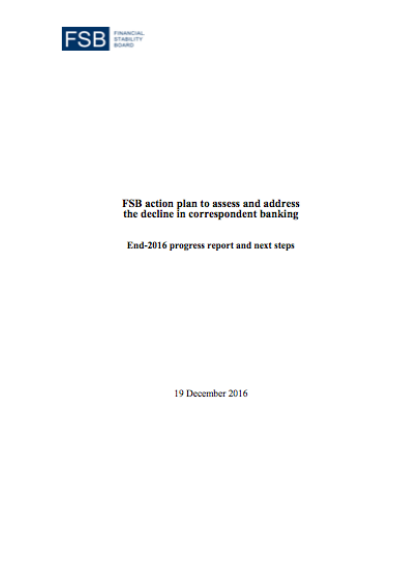
References



- FATF Guidance
- February 2013
- AML/CFT Measures and Financial Inclusion



- World Bank
- October 2015
- Survey on De-Risking Activities in the Remittance Market



- FSB
- December 2016
- De-Risking
- Cause for concern



- SWIFT
- August 2016
- May make business sense for the individual banks
- Wider consequences

1. Concept of Derisking

Topics

- What is derisking?
- What is happening?
- Derisking example

What is Derisking?

Description

- “Generally speaking, de-risking refers to the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to **avoid, rather than manage, risk** in line with the FATF’s risk-based approach” FATF, 2014
- “Situations where financial institutions terminate or restrict business relationships with **categories of customers**” – FATF, 2015

Is all derisking bad?

- Good derisking
- Bad derisking

Perspectives

- Country level
- Institution level

Definition

To make something safer by reducing the possibility that something bad will happen and that money will be lost

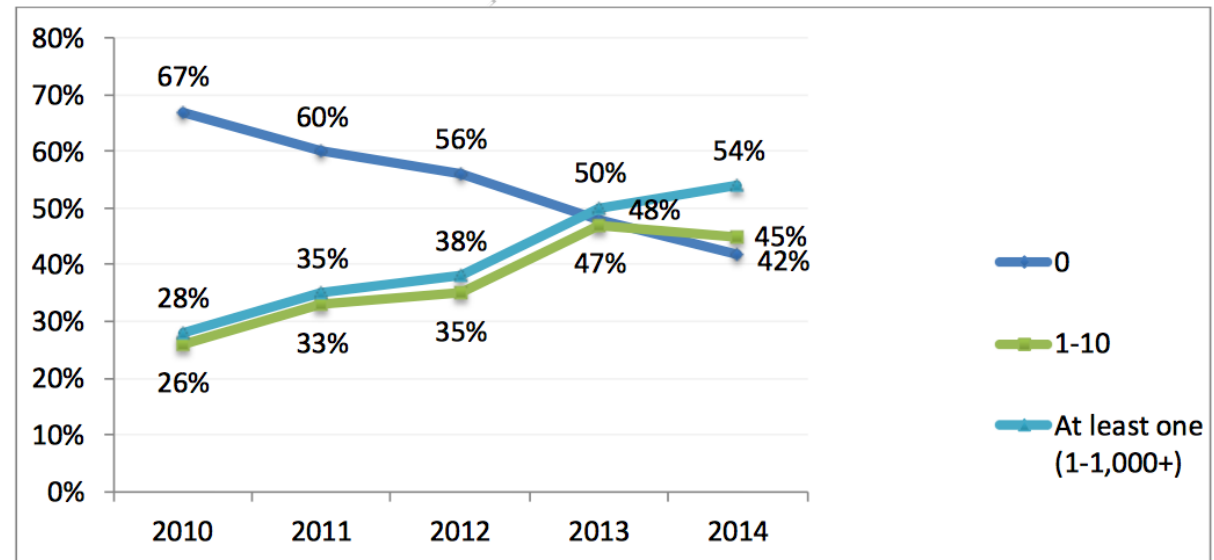
<http://dictionary.cambridge.org/us/dictionary/english/derisk>

What is Happening?

G20 Survey, 2015

- The “de-risking” trend impacts more MTOs today than a few years ago
- Decline in correspondent banking relationships
- The MTOs business model is often perceived as high risk.
- However, the survey “highlights a rather low number of violations of the relevant legal requirements”

Has your firm, as principal MTO, had bank accounts closed that impede your ability to provide international remittance services? Please record the number of accounts closed.



The main drivers for MTO account closure include:

- Profitability
- Pressure from other actors (correspondent banks) and fear of regulatory scrutiny
- Lack of confidence in the MTOs' procedures
- Reputational risk

Desrisking Example

Somalia

- Dependent on remittances
- Diaspora remits approx US\$1.3 billion to Somalia (per annum)
- Mainly via the Somali money transfer operators (MTO)
- Estimated at 25-45% of Somali GDP
- Greater than all the income it receives from aid, foreign direct investment, and exports combined
- Country risk - High
 - OFAC list - al-Shabab concerns
 - Political risk
 - Economic risk
 - Crime risk



- Bank closed the accounts of money transfer organizations (MTO) – 2013/14
- Dahabshiil and a number of others
- MTOs outside the risk appetite

2. Consistency with FATF Standards

Topics

- Drivers of derisking
- FATF perspectives
- R.1 – Assessing risks and applying a risk-based approach
- R.10 – Customer due diligence
- R.13 – Correspondent banking
- R.14 – Money value transfer services
- R.15 – New technologies
- R.16 – Wire transfers

Drivers of Derisking

FATF acknowledgement

Brisbane, 26 June 2015 - Situations where financial institutions terminate or restrict business relationships with categories of customer (so-called “de-risking”) is a **complex issue** that goes far beyond anti-money laundering (AML) and counter-terrorist financing (CFT). The FATF has gathered preliminary information on the potential drivers of “de-risking”, with input from the private sector which highlights that there is a **continued need to improve the evidence base** in order to determine the causes, scale and impact of de-risking. The FATF approach to “de-risking” is based on the **FATF Recommendations** which require financial institutions to identify, assess and understand their money laundering and terrorist financing risks, and implement AML/CFT measures that are commensurate with the risks identified.

Key concerns

- Complex issue that goes far beyond anti-money laundering (AML) and counter-terrorist financing (CFT)
- Continued need to improve the evidence base in order to determine the causes, scale and impact of de-risking
- The FATF approach to “de-risking” is based on the *FATF Recommendations*

Drivers of Derisking

FATF acknowledgement

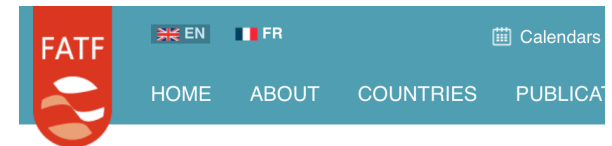
“De-risking can be the result of various drivers, such as concerns about profitability, prudential requirements, anxiety after the global financial crisis, and reputational risk. It is a misconception to characterise de-risking exclusively as an anti-money laundering issue” - FATF, 2014

Drivers

- Profitability
- Prudential requirements
- Anxiety after the global financial crisis
- Reputational risk

Observation

- Increasing understanding of derisking



[Home](#) / [Publications](#) / [FATF Recommendations](#)
/ FATF clarifies risk-based approach: case-by-case, not wholesale de-risking

FATF clarifies risk-based
approach: case-by-case, not
wholesale de-risking

<http://www.fatf-gafi.org/publications/fatfrecommendations/documents/rba-and-de-risking.html>

FATF Perspectives

FATF position i.r.o. derisking

“De-risking” should never be an excuse for a bank to avoid implementing a risk-based approach, in line with the FATF standards. The FATF Recommendations only require financial institutions to terminate customer relationships, on a case-by-case basis, where the money laundering and terrorist financing risks cannot be mitigated. This is fully in line with AML/CFT objectives. What is not in line with the FATF standards is the wholesale cutting loose of entire classes of customer, without taking into account, seriously and comprehensively, their level of risk or risk mitigation measures for individual customers within a particular sector.”

Considerations

- Derisking should never be an excuse
- Terminate customer relationships
 - On a case by case basis only - Where ML/TF cannot be mitigated
 - Seriously and comprehensively take into account the level of risk or risk mitigation

What Risk is Being Addressed?

When the FATF talks about risk – what risk?

- Regulatory risk
- Compliance risk
- ML risk
- TF risk

When you conduct due diligence, what risk is being mitigated?

- As a baseline:
 - “Don’t do business with someone you do not know”
 - This does not necessarily mitigate ML/TF risk

De-marketing

- in some cases, banks will exit the relationship solely on the basis of profits (“de-marketing”), irrespective of the risk context and of market circumstances

Recommendation 1

R1. Assessing risks and applying a risk-based approach – “Countries should”

- Identify, assess, and understand ML and TF risks for the country
- Take action, including designating an authority or mechanism to coordinate actions to assess risks, and apply resources, aimed at ensuring the risks are mitigated effectively
- Based on that assessment, countries should apply a RBA to ensure that measures to prevent or mitigate ML and TF are commensurate with the risks identified
- Essential foundation to efficient allocation of resources across the AML/CFT regime and the implementation of risk-based measures throughout the FATF Recommendations
- Where countries identify higher risks, they should ensure that their AML/CFT regime adequately addresses such risks
- Where countries identify lower risks, they may decide to allow simplified measures for some of the FATF Recommendations under certain conditions
- Require FIs and DNFBPs to identify, assess and take effective action to mitigate ML and TF risks

Perspectives

- Country
- Institution

Questions

- What is the end game?
- What does success look like?
- Is there alignment?
- What governance is needed?

Recommendation 10

Customer due diligence

“Financial institutions should be prohibited from keeping anonymous accounts or accounts in obviously fictitious names.

Financial institutions should be required to undertake customer due diligence (CDD) measures when:

- (i) establishing **business relations**;
- (ii) carrying out **occasional transactions**: (i) above the applicable designated threshold (USD/EUR 15,000); or (ii) that are wire transfers in the circumstances covered by the Interpretive Note to Recommendation 16;
- (iii) there is a **suspicion** of money laundering or terrorist financing; or
- (iv) the financial institution has **doubts** about the veracity or adequacy of previously obtained customer identification data.”

In a rules approach, typically:

- Name
- Date of Birth
- ID Number
- Address
- Contact number

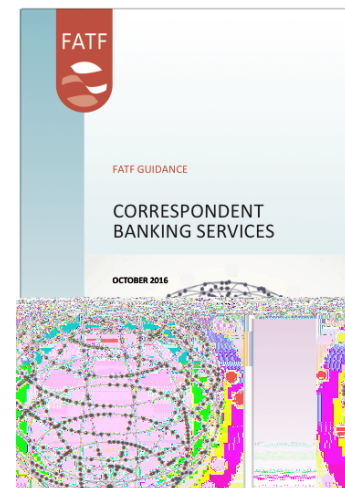
- Why did this happen?
- FATF standards are not prescriptive
- Identification and verification
- Proportionate responses
- We are where we are – What is the way forward?

Recommendation 13

Correspondent banking

“Financial institutions should be required, in relation to cross-border correspondent banking and other similar relationships, in addition to performing normal customer due diligence measures, to:

- (a) gather **sufficient information** about a respondent institution to understand fully the nature of the respondent’s business and to determine from publicly available information the reputation of the institution and the quality of supervision, including whether it has been subject to a money laundering or terrorist financing investigation or regulatory action;*
- (b) assess the respondent institution’s AML/CFT **controls**;*
- (c) obtain **approval** from senior management before establishing new correspondent relationships;*
- (d) clearly understand the **respective responsibilities** of each institution; and*
- (e) with respect to “**payable-through accounts**”, be satisfied that the respondent bank has conducted CDD on the customers having direct access to accounts of the correspondent bank, and that it is able to provide relevant CDD information upon request to the correspondent bank.”*



- Not require KYCC
- Monitor respondent institution’s transactions
- Respondent institution’s risk profile
- RFI on any particular transaction

Recommendation 14

Money Value Transfer Services

*“Countries should take measures to ensure that natural or legal persons that provide money or value transfer services (MVTs) are **licensed or registered**, and subject to effective systems for monitoring and ensuring **compliance** with the relevant measures called for in the FATF Recommendations. Countries should take action to identify natural or legal persons that carry out MVTs **without a license or registration**, and to apply appropriate sanctions.*

*Any natural or legal person working as an **agent** should also be **licensed or registered** by a competent authority, or the MVTs provider should maintain a current list of its agents accessible by competent authorities in the countries in which the MVTs provider and its agents operate. Countries should take measures to ensure that MVTs providers that use agents include them in their AML/CFT **programmes** and monitor them for compliance with these programmes.”*



- **Supervisors** should clarify expectations – management of risk
- Avoid overly conservative compliance
- Provides examples of CDD practices

Recommendation 15

New technologies

*“Countries and financial institutions should identify and assess the money laundering or terrorist financing risks that may arise in relation to (a) the development of **new products and new business practices**, including new delivery mechanisms, and (b) the use of **new or developing technologies** for both new and pre-existing products. In the case of financial institutions, such a risk assessment should take place **prior to the launch** of the new products, business practices or the use of new or developing technologies. They should take appropriate measures to manage and **mitigate** those risks.”*

Perspectives

- Firstly, opportunities to misuse technologies for ML/TF.
- On the other hand, technologies provide opportunities for improved AML/CFT responses:
 - Fintech
 - Regtech



- What question is being answered i.r.o. AML/CFT?

Recommendation 16

Wire transfers

*“Countries should ensure that financial institutions include required and accurate **originator** information, and required **beneficiary** information, on wire transfers and related messages, and that the information remains with the wire transfer or related message **throughout the payment chain**.*

*Countries should ensure that financial institutions **monitor** wire transfers for the purpose of detecting those which lack required originator and/or beneficiary information, and take appropriate measures.*

*Countries should ensure that, in the context of processing wire transfers, financial institutions take **freezing action and should prohibit conducting transactions** with designated persons and entities, as per the obligations set out in the relevant United Nations Security Council resolutions, such as resolution 1267 (1999) and its successor resolutions, and resolution 1373 (2001), relating to the prevention and suppression of terrorism and terrorist financing.”*



FATF guidance

- TF risks
- What risk appetite for TF?

Parties

- Originator
- Ordering Institution
- Intermediary Institution
- Beneficiary Institution
- Beneficiary/Payee

3. Why Some FIs De-risk

Topics

- Derisking research
- Level of understanding of derisking
- Graduated approach
- Risk appetite
- Identity and identification
- Cost of compliance

Desrisking Research

Dow Jones & ACAMS - Global Anti-money Laundering Survey Results 2016

Have exited

40% of respondents report their companies **have exited** a full business line or segment of business in the past 12 months due to perceived regulatory risk and/or the organization's inability to manage the risk - Increase from 2015



Planning to exit

About **one-third** of respondents claim their companies are **planning to exit** and/or are investigating the possibility of exiting a business line or segment in the next 12 months due to regulatory risk

Desrisking Research

Source: Dow Jones & ACAMS

Types of Segments Considering Exiting	%
Industries that have been designated high-risk by government agencies	51%
Specific products/product lines	45%
Specific geographic area(s)	40%
Non-governmental organizations (NGOs) or charities	14%
Other	8%
Reasons Considering Exiting Segment - 2016	%
Segment no longer within organization's risk appetite	56%
Cost of compliance makes segment unprofitable	51%
Segment draws excessive regulatory oversight	40%
No confidence regulators will approve risk management approach	20%
Segment is generally unprofitable	18%
Other	1%

Level of Understanding?

How well do regulators understand the drivers

- Profitability considerations
- Reputational and liability risks
- Changes in banks' financial risk appetites
- The amount of financial penalties imposed by supervisory and law enforcement authorities
- Increased compliance costs associated with implementing conflicting regulatory requirements, including AML/CFT
- Confusion caused by the term KYCC
- Complexity, number and changes in sanctions regimes, and also uncertainty related to the interplay of different sanctions regimes and their applicability to financial institutions

Questions:

1. How well do AML/CFT stakeholders understand the drivers of derisking?
2. What is needed to avoid unintended consequences of AML/CFT requirements in future?

Graduated Approach

Draft RBA Guidance - Published June 2017 (SA)

Higher risk

- Enhanced due diligence
- Where the risk of abuse is assessed to be **higher**
- Systems and controls should provide for:
 - **More information** to be obtained about clients
 - **More secure confirmation** of clients' information to be applied
 - **Closer scrutiny** to be conducted to their clients' transaction activities

Lower risk

- Simplified due diligence
- Where the risk of abuse is assessed to be **lower**
- Systems and controls may allow for:
 - **Less information** to be obtained
 - **Less secure confirmation** of information to be applied
 - **Less frequent scrutiny** to be conducted

Questions:

1. What are the most significant capacity building opportunities i.r.o. AML/CFT frameworks?
2. Where should the focus be in respect of the supervision of AML/CFT requirements?
3. What regional support is needed in respect of the development of institutional RBAs ?
4. What regional support is needed to promote financial inclusion and improve the prospects for financial integrity?

Risk Appetite

Source: FSDA

Address risk appetite considerations

- In determining the desired outcomes of an NRA and RBA, **countries** in sub-Saharan Africa should consider their risk appetite
 - Risk cannot be eliminated completely
- This is not **specifically / comprehensively** addressed in FATF recommendations or guidance that has been published by the FATF
- There would be value in developing a **regional conversation**
 - Institutions will determine their risk appetite as part of their risk management framework and process, i.e. relating to compliance, ML/TF and other risks
 - A robust understanding of the dynamics relating thereto will assist in avoiding so-called de-risking

COSO

"... the amount of risk, on a broad level, an organisation is willing to accept in pursuit of value."

King III

"The level of residual risk the company is prepared or willing to accept without further mitigation action being put in place, or the amount of risk the company is willing to accept in pursuit of value."

Risk Appetite

Zero tolerance

- Draft guidance – para 56

“The risk-based approach is not a “zero failure” approach as there may be occasions where an institution has taken all reasonable measures to identify and mitigate ML/TF risks, but it is still exploited for money laundering or terrorist financing purposes.”

- How far have we come with this?
- You get the sense that it is possible that there could, across more stakeholders, be a shared vision of success
- However, this is not a linear debate – Its complex
- There is an interrelationship between compliance risk and ML/TF risk

Source: FSDA

Setting of

- Risk appetite
- Risk tolerances

Governance

- Strategy
- Structure
- Ethics
- Culture

Roles & responsibilities

- Board
- Management
- Compliance
- Risk
- Audit

Identity and Identification

Draft RBA Guidance - Published June 2017 (SA)

Identity

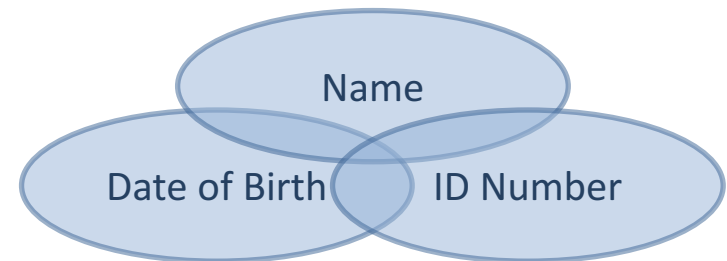
Identity can be determined by reference to a number of characteristics - At the very basic level, these characteristics are the person's:

- full names,
- date of birth and,
- in most cases, a unique identifying number issued by a government source.

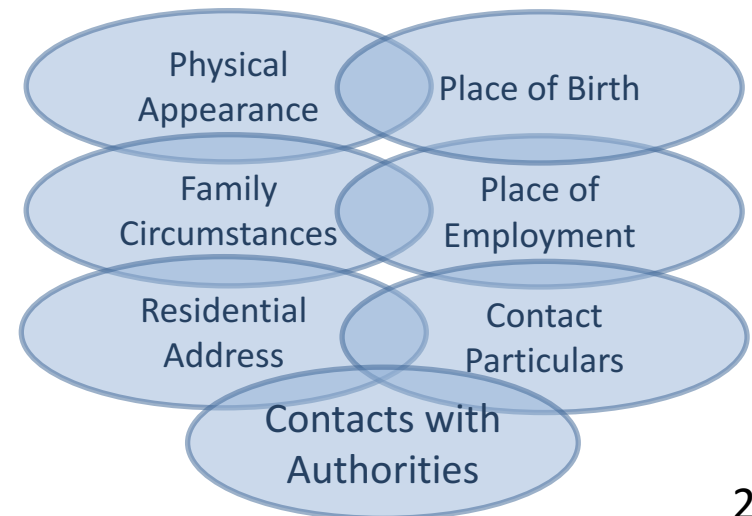
Information about a natural person's identity may be supplemented by applying other characteristics of a natural person including:

- his/her physical appearance or other biometric information,
- place of birth,
- family circumstances,
- place of employment or business,
- residential address,
- contact particulars (e.g. telephone numbers, e-mail addresses, social media),
- contacts with the authorities (e.g. tax numbers) or with other accountable institutions.

Basic characteristics of a natural person



Other characteristics of a natural person



Cost of Compliance

Developing understanding of costs

“The reasons we have heard for the restriction or termination of correspondent banking relationships are mixed. The predominant one points to the high cost of compliance for global correspondent banks stemming from heightened anti-money laundering and counter financing of terrorism (AML/CFT) requirements. The correspondent banks say this cost of compliance dwarfs the business returns from smaller territories, particularly if they are classified as high risk clients and products. In this context, correspondent banks are apprehensive about doing business with money transfer operators and remittance companies.”

Source: IMF/World Bank 2016 Annual Meetings Small States Form Speech



IMF/WORLD BANK 2016 ANNUAL MEETINGS SMALL STATES FORM SPEECH

presented by
The Honourable Audley Shaw CD, MP.
Minister of Finance and the Public Service

TOPIC: EQUITABLE GROWTH, FINANCE AND INSTITUTIONS

SUB – TOPIC: DE- RISKING AND REMITTANCES IN THE CARIBBEAN

Questions:

1. What are the costs?
2. Why is there not more empirical data relating to costs?
3. What are the cost drivers?
4. How do you develop the understanding of costs?

Cost of Compliance

Do institutions have capacity?

- Systems
 - Legacy systems
 - Single view of customer
 - Client relationships vs single transactions
 - CDD and risk data
 - Monitoring
- New risk processes
 - ML/TF risk assessment
 - Process vs event
- Risk management knowledge, skills and experience
 - First line of defence – risk owner
 - Second line of defence – support
 - Third line of defence – assurance

Source: FinMark Trust, 2016

Project Approach

Cost categorised

- Systems
- Processes
- People
- Other

Types of cost

- Fixed vs variable
- Upfront vs ongoing

Stakeholder engagement

- Data
- Modelling

4. Is Derisking an Escape Route?

Topics

- Escape route?

Escape Route?

You have to ask - Escape route from what?

- Business risk
- Product risk
- Delivery channel risk
- Client risk
- Geography risk

Escape from past sins?

- Due diligence
- Reporting
- Record keeping
- Training
- Monitoring

Perspectives

- Country
- Institution

Risk responses

- Transfer
- Tolerate
- Treat
- Terminate

Is derisking an escape route?

- Yes
- No

Why was derisking a surprise to AML/CFT stakeholders?

5. Implications for AML/CFT

Topics

- Key issues
- Way forward

Key Issues

As recognised by FATF

Introduce risk and opacity:

- Into the global **financial system**
- **Termination of account relationships** has the potential to force entities /persons into less regulated or unregulated channels
- Moving funds through **regulated, traceable channels** facilitates the implementation of AML/CFT measures

Financial inclusion:

- It is **central to the FATF mandate** to ensure that the global AML/CFT standard is well understood and accurately implemented
- Countries and their financial institutions should be provided with support in designing AML/CFT measures that **meet the goal of financial inclusion**

*“This is a serious concern for the FATF and the FATF-style regional bodies (FSRBs) to the extent that de-risking may drive financial transactions into less/non-regulated channels, reducing transparency of financial flows and creating financial exclusion, thereby **increasing exposure to money laundering and terrorist financing (ML/TF) risks.**”*

Way Forward

What is the end game?

- What does success look like?
- Is there alignment?
- What governance is needed?
- Who should develop ML/TF risk standards?
- What mitigates compliance risk and by how much?
- What mitigates ML risk and by how much?
- What mitigates TF risk and by how much?
- Is a high risk appetite bad?
- What are the measures of success?

Contact: Lucy Mabena
lucym@yebo.co.za
+27 11 463 5769

Thank You



Governance, Risk, Compliance
John Symington