Assessment of AML/CFT in the Particular Context of Financial Inclusion

AFI, SBS Peru and WB Forum, Lima Peru, May 12-13 2011

Pierre Laurent Chatain
Lead Financial Sector Specialist
(Financial Systems)
The World Bank
Agenda

1) How do we define financial inclusion and why is it important?

2) What is an AML/CFT Assessment?

3) What FATF recommendations are particularly relevant to promoting a country’s financial inclusion objectives?

4) What are the key questions in reference to these FATF recommendations assessors should be asking during the assessment process to incorporate development of mobile money and financial inclusion?
What is Financial Inclusion?

1) Financial Inclusion brings the excluded population that is currently in the informal, undocumented, unmonitored and unregulated system into the formal, transparent, and protective financial system — **A crucial AML/CFT objective**

2) Financial Inclusion and AML/CFT complementary objectives

3) Common Misperception that financial inclusion poses greater risks to ML/TF because financial inclusion often refers to and targets:

   - people unable to provide proof of ID or do not carry “traditionally legitimate” IDs
   - Alternative methods of payment
   - Involves Cash-Intensive Businesses
   - The development of cross-border financial services that are often designated as higher risk services
What are AML/CFT Assessments?

- AML/CFT assessments gauge the strength and effectiveness of a country’s efforts in the area of Anti-Money Laundering and Combating Financial Terrorism (AML/CFT).

- AML/CFT reports can be conducted as part of the Financial Sector Assessment Program (FSAP) or as mutual evaluations for FSRB-purposes.

- Most of the reports are published.
AML Assessments: Component of FSAPs

- Core Standards
  - Regulatory and Supervisory
    - Banking (BCP)
    - Insurance (IAIS)
    - Securities (IOSCO)
  - Transparency and Disclosure
    - Code of Good Practices on Transparency in Monetary and Financial Policies (IMF)
  - Institutional and Market Infrastructure
    - Payments and Settlement (CPSS, CPSS-IOSCO)
    - AML/CFT (FATF)
    - Corporate Governance (OECD)
    - Accounting (IASB)
    - Auditing (IFA)
    - Insolvency & Creditor Rights (Bank/UN)
What are AML/CFT assessments?

These assessments are diagnostic tools, identifying flaws or gaps and making recommendations to improve the country’s AML/CFT framework.

Each assessment is based on the most recent common assessment methodology, and is designed to provide a description of a country’s AML/CFT regime.

In order to ensure the consistency and fairness of assessments, all assessor bodies (FATF, FATF-Style Regional Bodies, IMF, World Bank) have prepared an assessment methodology that is used for all assessments.
Current Scenario: AML/CFT Assessments

- Majority of countries have undergone full AML/CFT assessments

- FATF and some FSRBs moving to a more targeted / risk-based / effectiveness driven approach to assessments
The “New” FSAP

Objectives:

- Make FSAP more flexible, nimble, and responsive to country circumstances
- Improve the quality of assessments and enhance candor, comparability
- Incorporate objectives of Financial Inclusion
WHAT ARE THE QUESTIONS ASSESSORS SHOULD BE ASKING TO INCORPORATE NEW TECHNOLOGIES AND A COUNTRY’S FINANCIAL INCLUSION SCENARIO?

* The following slides are based upon the World Bank publication, “Protecting Mobile Money Against Financial Crime” and are solely the views of its authors.
Assessors may wish to consider the following:

- whether the country supports its financial integrity objectives with a financial inclusion policy;

- whether financial inclusion initiatives, if any, pay due regard to and are aligned in objectives and implementation with the international standards; and

- whether the country has taken care to ensure that AML/CFT controls are not unnecessarily undermining financial inclusion.
Assessment of AML/CFT Standards

- When assessing compliance with AML/CFT standards, assessors will have to take into consideration possibly financial inclusion objectives in the future

  - This approach may have some impact on the rating to be applied

  - 6 FATF Standards are particularly challenging to assess in relation to financial inclusion and new technologies

    - Recommendation 5, 10, 13, 29, 30 and 32
Challenge: From a financial inclusion perspective, what to do with customers who are undocumented and do not have any legitimate IDs?

Solution: The assessors should consider how AML/CFT requirements, in particular those relating to customer identification, have been reduced or simplified to facilitate access of undocumented customers. To be fully convinced that the flexibility was appropriately applied, the assessor should ask:

- Did the country undertake a risk assessment before relaxing KYC for specific low risk mobile money products?
- Is the risk assessment sufficiently robust to satisfy authorities and assessors for mobile banking products carrying a low risk?
- Was this assessment and its conclusion documented?
- Are the KYC exemptions clearly defined?
- Are the alternative IDs robust enough?
**Conclusion:** Credit may be given to the country by assessors if their questions have been properly addressed.
Record Keeping/FATF Rec. 10

**Challenge:** Since the provision of services for financial inclusion purposes may involve new players, assessors should verify whether these new entities are subject to record keeping obligations.

- In this regard, issues such as the following should be analyzed:
  - Whether the record-keeping obligations apply to financial institutions/service providers as well as to retailer outlets.
  - The legal nature of the obligations and how compliance is ensured.
  - Are competent authorities that follow due legal process to seek records from traditionally non financial institutions and entities able to access relevant information and evidence on a timely fashion?
Conclusion: Credit may be given to the country by assessors if their questions have been properly addressed.
Retailer Outlets

While retailer outlets are not required to be subject to licensing and regulation - if a country decides otherwise, it is advisable for assessors to consider the following points:

- What are the criteria used to license the retailer outlets?
- Must they meet a fit and proper test?
- Are retailer outlets subject to any oversight from a supervisory authority?
- How effective is the supervision of the retailer outlets’ compliance with AML/CFT obligations?
Retailer Outlets

Does the principal financial institution/service provider perform due diligence procedures on retailer outlets prior to recruitment?

Does the principal financial institution/service provider take sufficient steps to ensure that retailer outlets do not compromise any simplified AML/CFT control measures applicable to low value/low risk accounts?

As part of their assessments of the AML/CFT framework, evaluators should also consider:

- Do retailer outlets have AML/CFT obligations?
- Are these obligations clearly stated in a regulation or are they set out in a contractual arrangement?
- What is the exact scope of retailer outlet’s AML/CFT duties?
Retailer Outlets

Conclusion: If these issues are not properly adhered, assessors may lower a country’s ratings.
Challenge: Financial Inclusion, notably via mobile banking, involves new actors that are not necessarily banks...eg Telcos. Assessors should therefore evaluate how these actors comply with STR obligations.

Before rating compliance with rec. 13, assessors may wish to consider the following:

- Who is responsible for the identification and reporting of suspicious mobile money transactions?
  - Are retailer outlets required to report suspicions to the principal financial institution/service provider?
  - Is the principal financial institution/service provider responsible in law for reporting STRs, identified by it and by the retailer outlets, to the FIU?
  - Where is the reporting obligation for each responsible party detailed? Are these enforceable?
Reporting Obligations/ FATF Rec. 13

- Do the principal financial institution/service provider, network service provider, retailer outlets and their staff enjoy legal protection against criminal and civil liability for breach of any restriction on disclosure of information if they report suspicious transactions in accordance with their obligations?

- How does the system ensure that information is disclosed in accordance with the applicable legal rules, including privacy laws?

- How is it ensured that all relevant parties are aware of the obligations and have the ability to identify and report suspicious transactions?

- Is the principal financial institution/service provider required to provide initial and ongoing training to agents to assist them in identifying and reporting suspicious behaviors?
**Challenge:** How to evaluate compliance with supervision/enforcement standards in the particular context of financial inclusion? New players mean new responsibilities for supervision. The challenge is to determine whether these new responsibilities are clearly established and implemented by all players.

**FATF Rec. 29** requires supervisors to have adequate powers to monitor and ensure compliance by financial institutions with requirements to combat ML/TF, including the authority to conduct inspection.
In this regard, assessors may wish to consider the following in the particular context of financial inclusion and mobile money:

- Does the supervisory regime adhere to the FATF’s functional definition of “financial institution” or do some non-bank providers fall under different supervision for their financial services?

- If service providers (in particular, non-financial entities) are subject to different oversight regimes, is the delineation of duties between supervisory authorities clearly set in laws and understood by all parties?
Supervision and Enforcement / FATF
Rec. 29 and 30

Assessors should also ask the following questions in reference to FATF Rec. 29 and 30:

- What are the responsibilities of the supervisor?
- Is the supervisor able to supervise compliance by all parties who provide the service?
  - Are supervisors allowed to conduct onsite visits to all parties including MNOs?
  - Does supervisory powers extend to all AML/CFT aspects, for example, KYC, record-keeping and compliance with STR obligations?
  - How does the supervisor ascertain whether the necessary AML/CFT training is provided and that suspicious transactions are identified and reported correctly?
- Is every party to the financial inclusion product/service subject to sanction or other enforcement measures, should they be in breach of an AML/CFT obligation?
FATF rec. 32 also impacts financial products which aim to expand financial inclusion. This Recommendation requires countries to maintain comprehensive statistics on matters relevant to the effectiveness and efficiency of systems for combating ML/TF.

As a result, in countries where mobile money services are used, assessors should determine whether the FIU is keeping statistics on STRs received by those parties that are responsible for filing such reports, including MNOs.
THANK YOU!

Pierre Laurent Chatain
Lead Financial Sector Specialist
(Financial Systems)
The World Bank
pchatain@worldbank.org