



Anti-Money Laundering and Combating the Financing of Terrorism in Certain SADC Countries

Focus Note 1: Financial Inclusion and AML/CFT

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1. Introduction and overview

FinMark Trust commissioned and funded the development of the focus notes contained in this report in order to highlight key considerations relating to anti-money laundering (AML) and combating the financing of terrorism (CFT) in 13 Southern African Development Community (SADC) countries. This was undertaken in light of findings from a detailed review of the regulatory frameworks in these jurisdictions.

In various studies undertaken by FinMark Trust, the implications of AML and CFT regulatory requirements are often cited as a constraint to the development, growth and access to financial services and products. It has been reasoned that an inappropriate or inconsistently applied regulatory environment for domestic and cross border AML/CFT controls has a detrimental impact on the strategic objective of increasing financial integration and access to financial services within the region.

FinMark Trust would like to investigate whether the harmonisation and more appropriate calibration of the AML/CFT regulations across and within the SADC countries could enhance legal certainty and regulatory predictability. It has been motivated that, in the light of the expansion of African and international financial service providers in the SADC region, this legal harmonisation would have a positive impact on the development and release of financial services and products in the region.

The following focus notes, covering AML/CFT regulatory requirements in the SADC countries, have been developed to draw attention to key matters:

- Focus Note 1 - Financial inclusion and AML/CFT;
- Focus Note 2 - Risk-based approaches to AML/CFT;
- Focus Note 3 - AML / CFT due diligence and related matters;
- Focus Note 4 - Mobile services / technology; and
- Focus Note 5 - Harmonisation of regulatory frameworks in the SADC region.

A brief description of each of the focus notes is set out below.

Figure 1: Proportionate AML/CFT responses

Focus Note	Brief Description
1. Financial inclusion and AML/CFT	Considerations that are relevant in determining whether and how AML/CFT regulatory requirements in the participating countries are a financial inclusion constraint or not are discussed. Various studies that have been carried out indicate that AML/CFT legislation, implemented in response to the FATF Recommendations, has resulted in a conservative approach to compliance with this legislation by the regulated institutions. This is viewed in relation to levels of financial inclusion and economic conditions in SADC.
2. Risk-based approaches to AML/CFT	The adoption of a risk-based approach to the regulation of ML/TF is no longer optional. This is now required in terms of international standards ¹ . Key aspects thereof are considered with a view to identifying regulatory harmonisation opportunities as set out in Focus Note 5 - Harmonisation of regulatory frameworks in the SADC region. Where financial inclusion friendly AML/CFT requirements are

¹ In terms of FATF Recommendation 1.

Focus Note	Brief Description
	put in place, which allow for proportionate compliance responses according to the ML/CFT risk, this can play a positive role in promoting access to formal financial systems of countries. This can also potentially reduce the use of informal mechanisms that are outside of the authorities' scrutiny.
3. AML / CFT due diligence and related matters	Customer due diligence and related matters are described in light of relevant FATF Recommendations ² , specifically in view of financial inclusion dynamics, i.e. for the purpose of identifying themes that are relevant in the SADC region. Reference is made to the FinMark Trust country reviews ³ in this regard. While it is understood that customer due diligence that is undertaken by institutions is an important foundation on which AML/CFT compliance responses must rest, overly conservative compliance responses of institutions can result in access barriers.
4. Mobile services / technology	Key aspects of opportunities that can be derived from the introduction of mobile services and new technologies in the SADC region are highlighted. This is done in light of identified opportunities to support financial inclusion objectives. Various FATF Recommendations ⁴ are considered in order to provide the context for the analysis carried out. New technology opportunities and mobile services offer solutions that will, to a far greater extent than in the past, provide opportunities to deliver financial services to the underserved or excluded market.
5. Harmonisation of regulatory frameworks in the SADC region	AML/CFT harmonisation prospects relating to regulatory frameworks of countries in the SADC region are addressed. The underlying motivation in this regard is to put forward an analysis of various SADC regulatory requirements with a view to promoting opportunities to enhance legal certainty and regulatory predictability as well as support the strategic objective of increasing financial integration and access to financial services in the respective countries.

² Customer Due Diligence (CDD) (Recommendation 10); Record keeping requirements (Recommendation 11); Correspondent banking (Recommendation 13); Reliance on third parties (Recommendation 17); Internal controls (Recommendation 18); and Reporting requirements for suspicious transactions (Recommendation 20).

³ Published 13 May 2015.

⁴ Money or value transfer services (Recommendation 14), new technologies (Recommendation 15) and wire transfers (Recommendation 16).

2. Acknowledgements

This report has been prepared by Compliance & Risk Resources. It has been drafted taking into account the findings contained in the SADC country review reports that have been prepared for FinMark Trust⁵.

The level of cooperation and support provided by the SADC country stakeholders, who were consulted during the research phase of this project and the finalisation of the country reports, is acknowledged. The willingness of those who made themselves available to assist, often at very short notice, in all participating countries, is highly valued.

The report has been prepared by John Symington with assistance from the Compliance & Risk Resources team. Input has been obtained from a panel of experts, who provided insights and feedback relating to the design of the study. A sincere word of thanks is extended to Raadhika Sihin, Kim Dancey and Neal Estey for providing input. Dhashni Naidoo and Mojgan Derakhshani, FinMark Trust, provided feedback during the drafting process.

3. Methodology and scope

The production of focus notes for FinMark Trust has been prepared on the back of the detailed SADC country review reports prepared by the parties indicated in the acknowledgements in section 2 above.

The reports addressed the following topics:

- Legislation and Regulation in Force;
- Customer Due Diligence;
- Record Keeping;
- Correspondent Banking;
- Money Transfer Services;
- New Technologies;
- Wire Transfers;
- Reliance on Third Parties;
- Internal Controls;
- Suspicion Transaction Reporting; and
- Guidance and Feedback.

Thirteen countries participated in the study: Angola, Botswana, Democratic Republic of the Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Zambia and Zimbabwe. The review findings contained in the respective sections of the reports have been analysed and used as a platform to identify the regulatory requirements that are in place in each of the participating countries. This serves as a basis to develop recommendations relating thereto.

The Compliance & Risk Resources consulting team has made use of its knowledge and experience in respect of regulatory requirements in force in Sub-Saharan Africa and has referenced existing studies that address AML/CFT requirements and financial inclusion. It is noted that Compliance & Risk Resources was,

⁵ AML/CFT and Financial Inclusion in SADC - Consideration of Anti-Money Laundering and Combating the Financing of Terrorism Legislation in Various Southern African Development Community (SADC) countries. March 2015.

at the time this report was prepared, in association with Cenfri⁶, undertaking a project⁷ designed to engage AML/CFT stakeholders in Sub-Sahara countries in order to provide a platform from which to develop a sound understanding of national as well as sectoral AML/CFT risk assessments⁸. Accordingly, it is acknowledged that there has been an opportunity to use the knowledge gained during this engagement to inform the approach taken in developing these focus notes.

4. International standards and guidance

In view of the increasing focus on and understanding of the benefits that are derived from access to finance and financial services by communities in developing countries, both regionally and internationally, the impact of AML/CFT regulatory requirements on financial inclusion has been drawn into the spotlight. Notably, during the course of 2011, the Financial Action Task Force (FATF), following interest kindled under the G20 presidency by Mexico, agreed to have the issue of financial inclusion on its agenda and committed to examining potential challenges posed by AML/CFT requirements relating to the goal of achieving financial inclusion.

The FATF recommendations, which were revised in 2012⁹, now make the adoption of a risk-based approach mandatory. They provide space for financial inclusion to be recognised as a country policy objective and, accordingly, there is an opportunity for countries to shift the focus towards achieving AML/CFT objectives within an environment that does not compromise financial inclusion. It is encouraging that there has, in recent years, been steady progress towards recognising the importance of financial inclusion imperatives. This is particularly notable through the development of a FATF guidance paper in June 2011¹⁰, which was intended to provide support to countries in designing AML/CFT measures that meet a national financial inclusion goal without adversely impacting financial integrity objectives. This was revised in 2013, the main aims thereof being the development of a common understanding of the "FATF standards that are relevant when promoting financial inclusion and explicit the flexibility that the standards offer, in particular the risk-based approach (RBA), enabling jurisdictions to craft effective and appropriate controls."¹¹

⁶ Centre for Financial Inclusion - A non-profit think tank based in Cape Town which operates in collaboration with universities in the region to support financial sector development and financial inclusion through facilitating better regulation and market provision of financial services.

⁷ Financial Sector Deepening Africa (FSDA). Current research being undertaken entitled "Risk-Based Approaches to Regulation of AML/CFT".

⁸ This is designed to address key aspects of international guidance and examples of how jurisdictions have approached the adoption of a RBA by outlining the elements thereof as relevant to countries in the Sub-Sahara Africa region and assisting participating countries with a product scan to define parameters of risk at a sectoral level to get to grips, in a practical way, with what low and high money laundering (ML) and terrorist financing (TF) risk could entail. The project directly addresses financial inclusion related considerations, noting that the application of the RBA will not be limited to financial inclusion impacts.

⁹ FATF. International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation - The FATF Recommendations. 2012.

¹⁰ FATF, APG and World Bank. FATF Guidance - Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion. June 2011.

¹¹ FATF, APG and World Bank. FATF Guidance - Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion. February 2013.

Other FATF guidance, relating to AML/CFT and the risk-based approach, has also touched on AML/CFT and financial inclusion. For example, the following question is raised: "Does the manner in which AML/CFT measures are applied prevent the legitimate use of the formal financial system, and what measures are taken to promote financial inclusion?"¹². This refers to the issue of whether financial institutions and designated non-financial businesses and professions (DNFBP) adequately apply AML/CFT preventive measures commensurate with their risks and report suspicious transactions. Further, there have been a number of publications by international organisations that have shed light on this topic, for example published by AFI¹³ and CGAP¹⁴, which illustrates the growing momentum that has been gained and the international understanding of the impact of AML/CFT requirements on financial inclusion.

5. Focus Note 1 - Financial inclusion and AML/CFT

5.1. Introduction

This focus note highlights considerations that are relevant in determining whether and how AML/CFT regulatory requirements in the participating countries are a financial inclusion constraint or not. Various studies that have been carried out indicate that AML/CFT legislation, implemented in response to the FATF Recommendations, has resulted in a conservative approach to compliance with this legislation by the regulated institutions (caused by fear of regulatory/supervisory intervention as well as other interrelated factors). This does not encourage or facilitate financial inclusion. SADC country interpretations of the FATF recommendations have, to a significant degree, represented a challenge for the region. This is particularly the case where national identity systems and residential address systems do not lend themselves to obtaining identity and address verification documentation that is readily available, i.e. to the extent that it is in developed countries.

As a point of departure, various aspects of a financial inclusion strategy of a country are considered below, i.e. in the light of economic development dynamics. This leads into a discussion of financial inclusion in relation to AML/CFT requirements that are imposed in the SADC countries.

5.2. Focus Note 1 executive summary

The FATF Recommendations are, in the main, principle-based and provide countries with the flexibility to implement regulatory frameworks that are appropriate to their circumstances. However, in practice, the reality can be seen quite differently, notably where countries adopt inflexible and inclusion unfriendly frameworks. When coupled with rigorous supervisory practices and other factors, this can lead to overly conservative compliance responses by institutions. On the other hand, where regulatory requirements provide for flexibility relating to due diligence, this is not always applied by financial institutions in a manner that supports financial inclusion.

There is a relatively low level of financial inclusion in some SADC countries. The extent to which AML/CFT requirements contribute towards such financial exclusion is relevant. Further, in view of the relatively high

¹² FATF. Methodology for assessing technical compliance with the FATF recommendations and the effectiveness of AML/CFT systems. February 2013.

¹³ Alliance for Financial Inclusion - A global network of financial policymakers from developing and emerging countries working together to increase access to appropriate financial services for the poor.

¹⁴ Consultative Group to Assist the Poor - An organisation which has the objective of advancing financial inclusion to improve the lives of the poor.

poverty levels in some SADC countries, increasing access to finance and financial services has been identified as an opportunity to contribute towards alleviating poverty and stimulating economic development.

The indications are that countries generally understand the need to develop and implement financial inclusion strategies. This is indicated in the regional focus thereon at various international forums from an AML/CFT perspective. There is also an increasing recognition that financial integrity and financial inclusion objectives are not necessarily in conflict. Those sectors of the population that are informally served or excluded will, for the most part, fall outside of the purview of the AML/CFT regulatory authorities and the ML/TF risks may not be brought to light. It can be argued that low levels of financial inclusion could result in the overall country ML/TF risk being misunderstood. This could also result in an increase in the overall country risk in that the excluded segment of the population will not be subject to formal risk mitigation processes at country or institutional levels.

Challenges faced by consumers that are financially excluded include low income levels and rural living circumstances that may not place them in a geographical position that enables or encourages the use of formal financial services. Such consumers may also, to a significant extent, be undocumented and not have easy access to identification and address verification alternatives. Due diligence requirements may also add to the cost of doing business with consumers. They can also introduce significant operational and administrative challenges that can ultimately result in compliance risk for institutions. The extent to which AML/CFT requirements adversely impact on financial inclusion should be determined. However, this should be viewed holistically and understood in the light of other contributing factors.

It is perhaps fair to say that the initial driver for the development of AML/CFT regulatory frameworks was the need for countries to comply with the FATF Recommendations. The frameworks were, to some extent, not put in place with a specific focus on the impact thereon in respect of non-AML/CFT related considerations. Structured (often inflexible) approaches taken by regulators have, in some instances, been conservative and have had an adverse impact on financial inclusion. On the other hand, flexible risk-based approaches can lead to high levels of regulatory uncertainty that can also result in conservative compliance responses, particularly where there is not adequate regulatory guidance. An assessment of the ML/TF risks in the SADC region should ideally be undertaken prior to determining the approach that should be undertaken in respect of the design, development and implementation of a regulatory framework in a country. This should be designed to provide a sound understanding of local circumstances. It should also position how best to address the intersect between financial integrity (avoidance of abuse of the financial system for ML and TF purposes) and financial inclusion (access to finance and financial services).

The question of whether AML/CFT objectives are being achieved should be addressed, i.e. through the compliance responses of institutions to the regulatory framework that is put in place in each country.

5.3. Financial inclusion strategy

A financial inclusion strategy is a comprehensive public document developed through a broad consultative process involving private and public sector stakeholders involved in financial sector development to systematically accelerate the level of financial inclusion¹⁵. In general terms, financial inclusion involves providing access to an adequate range of safe, convenient, appropriate and affordable

¹⁵ AFI Financial Inclusion Strategy Peer Learning Group (FISPLG).

financial products and services to consumers, including low income, rural and undocumented persons, who have been underserved or excluded from the formal financial sector. Financial inclusion can also be seen in terms of the provision of financial products in a fair and transparent manner.

The indications are that countries generally understand the need to develop and implement financial inclusion policies, and international bodies recognise the importance thereof. This is evident in a number of recent Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) interventions where financial inclusion was an agenda item. However, the question of whether the aforementioned translates into an appropriate focus thereon by stakeholders that are directly responsible for drafting AML/CFT regulatory requirements, and navigating these through the law making process, should be considered. It would also be beneficial to reflect on whether important financial inclusion perspectives are effectively addressed by the respective country AML/CFT supervisors, notably in respect of AML/CFT risk that is introduced through abuse of the informal sector. It is recommended that, in this regard, there should be co-ordination and communication between the highest levels of government, i.e. between stakeholders that are responsible for financial inclusion and financial integrity policies respectively.

The achievement of financial inclusion objectives will play a role in promoting economic development. This is intuitively a sound value statement. It is reasoned that benefits would be derived from a detailed understanding of the aforementioned, notably in respect of the nature and extent of the correlation between financial inclusion and economic development and the relationship thereof with AML/CFT requirements. CGAP specifically focuses on this issue and indicates that there is a tangible correlation between financial inclusion and economic development. The following is stated in this regard “recent evidence using rigorous research methodologies appears to generally confirm the policy makers’ convictions that inclusive and efficient financial markets have the potential to improve the lives of citizens, reduce transaction costs, spur economic activity, and improve delivery of other social benefits and innovative private-sector solutions.”¹⁶

Further, governance in the public and private sectors of a jurisdiction has a major impact on economic development opportunities. It is reasoned that good governance, as a direct and indirect consequence thereof, will result in the avoidance or management of conflicts of interests in and between organisations as well as between individuals and groups in a society, which in turn has an impact on broad-based economic development opportunities. It can be argued that AML/CFT requirements themselves represent a governance opportunity in that they deal with crime and the proceeds of crime in a manner that coordinates the efforts of a wide range of stakeholders, which can significantly improve the outlook of vulnerable people in society.

The broad perspectives outlined above, particularly in respect of the role that financial inclusion plays in respect of economic development and good governance, are beyond the scope of this report. However, further study thereof in relation to AML/CFT would yield valuable insights.

¹⁶ CGAP Focus Note. Robert Cull, Tilman Ehrbeck, and Nina Holle. Financial Inclusion and Development: Recent Impact Evidence. April 2014.

5.4. AML/CFT and financial inclusion

From an AML/CFT perspective, financial products and services should be provided through financial institutions subject to adequate regulation in line with the FATF Recommendations. It is recognised that it is important to protect a country's financial system from misuse. However, countries are able to "build AML/CFT regimes that specifically address their identified higher ML/TF risks while taking into account the importance of financial inclusion, both from an AML/CFT perspective and from a social policy point of view".¹⁷ There is increasing recognition that financial integrity and financial inclusion objectives are not necessarily in conflict. "Financial inclusion and an effective AML/CFT regime can and should be complementary national policy objectives with mutually supportive policy goals. Accordingly, the FATF Recommendations have flexibility, enabling jurisdictions to craft effective and appropriate controls taking into account the relevance of expanding access to financial services as well as the diverse levels and types of risks posed by different products and supply channels. The challenge is finding the right level of protection for a particular financial environment".¹⁸

Consideration of the controls and level of protection needed for an effective AML/CFT regime, as well as practical financial inclusion variables relating thereto, is beyond the scope of this report. It is suggested that there will be value in developing a SADC understanding thereof. This could be undertaken as part of a study designed to guide countries towards addressing such challenges without unduly compromising financial inclusion objectives.

It is useful to consider the financial inclusion profile of countries in the region. This is illustrated in the financial inclusion strands that are published in the FinScope survey¹⁹:

*Figure 2: FinMark Trust access strands - Consumer*²⁰

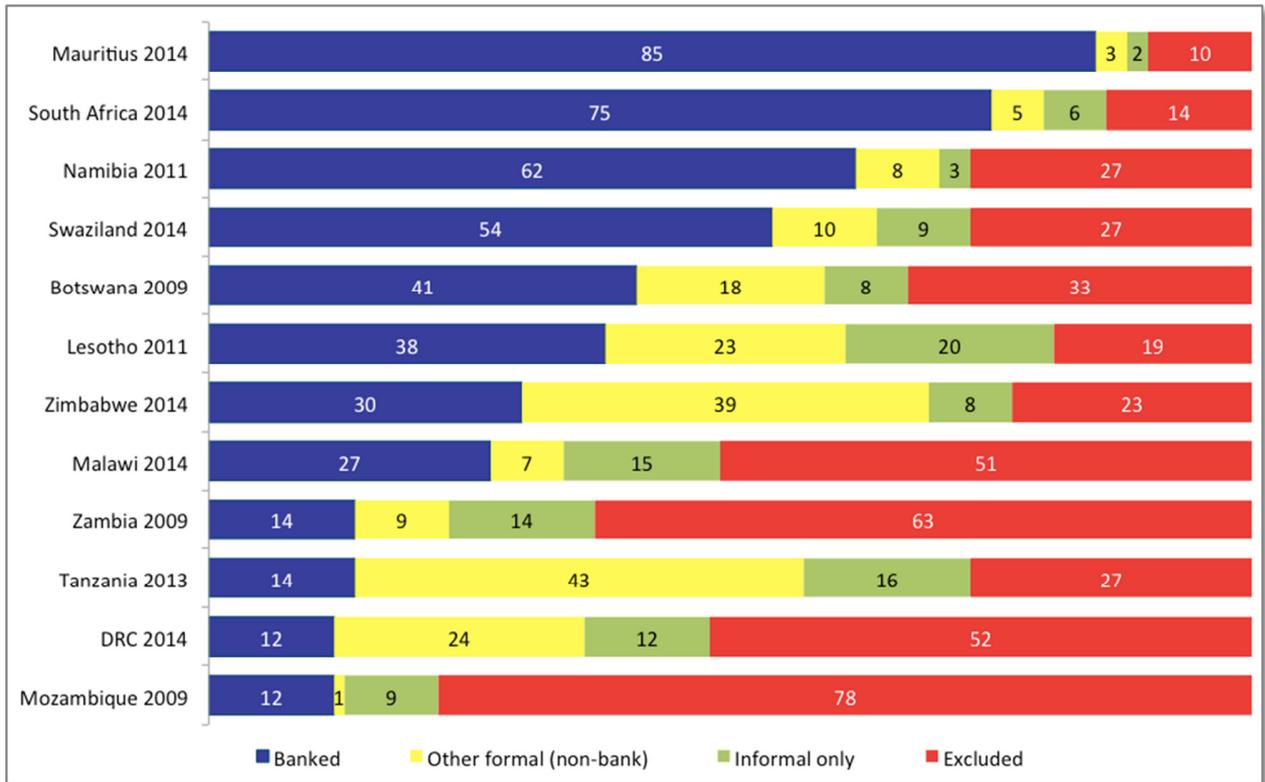
¹⁷ FATF, APG and World Bank. FATF Guidance - Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion. February 2013. Page 17.

¹⁸ FATF, APG and World Bank. FATF Guidance - Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion. February 2013. Page 15.

¹⁹ FinMark Trust Access strands reflect the following analysis segments:

- Excluded: Financially excluded adults, i.e. they do not use any financial products/services – neither formal nor informal – to manage their financial lives;
- Informal only: Adults who have/use informal mechanisms only but NO formal products/services;
- Other formal: Adults who have/use formal non-bank products/services but NO commercial bank products – they might also have/use informal mechanisms; and
- Banked: Adults who have/use commercial bank products/services – they might also have/use other formal and/or informal mechanisms.

²⁰ Current FinMark Trust Access strands obtained from FinMark Trust. March 2015.



The above reflects that although Mauritius and South Africa have relatively high financially included adult populations, while other countries in the region have low levels of financial inclusion. This is relevant from both an economic development purview, as well as from an AML/CFT standpoint. The promotion of financial inclusion is seen as an opportunity for encouraging economic development. On the other hand, the level of financial inclusion could, in itself, have an impact on the ML/TF risk in a country. In identifying, assessing and understanding ML/TF risks, the level of financial inclusion should be considered. Those sectors of the population of a country that are informally served or excluded will, for the most part, fall outside of the purview of the regulatory authorities and the ML/TF risks may not be brought to light.

The table that is set out below indicates the level of informally served or excluded consumers in Sub-Saharan Africa countries (where FinMark Trust has prepared such an analysis and highlights high-level observations relating thereto).

Figure 3: Informally served and excluded consumers

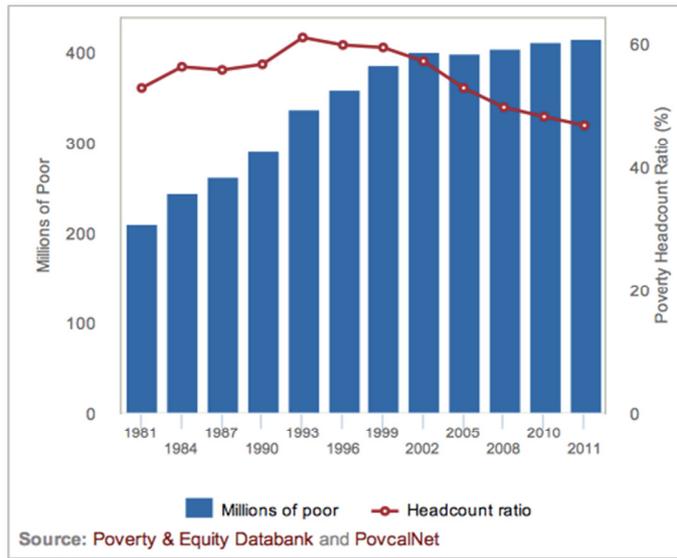
Country	% Informally Served or Excluded	Observations
Mozambique 2009	87	<p>14 out of 16 (88%) of the countries have populations that are 30% or more informally served or excluded:</p> <ul style="list-style-type: none"> • 7 countries (44%) 50%-100% informal/excluded • 7 countries (44%) 30%-49% informal/excluded • 2 countries (12%) 0%-29% informal/excluded <p>In light of this profile, the ML/TF risk arising from informally served or financially excluded persons should be considered – as described in section 5.6 of this paper.</p> <p>It is noted that the profiles of formally served consumers in some countries has changed significantly in recent years as a result of non-bank access. This is particularly evident in Zimbabwe where there is 39% non-bank formal access that has been driven by growth in mobile financial services. This compares to 14% non-bank formal access in 2011, a 25% increase over some 3 years. The drivers of such progress are relevant to understanding financial inclusion opportunities; perhaps most notably in respect of technology enabled delivery, as addressed in Focus Note 4 - Mobile services / technology.</p>
Zambia 2009	77	
Malawi 2014	66	
Ghana 2010	59	
Rwanda 2012	58	
Nigeria 2012	57	
Swaziland 2011	50	
Uganda 2013	46	
Tanzania 2013	43	
Botswana 2009	41	
Lesotho 2011	39	
Kenya 2013	33	
Zimbabwe 2011	31	
Namibia 2011	30	
South Africa 2014	20	
Mauritius 2014	12	

The level of poverty in the Sub-Sahara region provides the backdrop against which to view the need for economic development, i.e. in relation to the impact that AML/CFT requirements can have thereon. New technologies and delivery channels represent significant new opportunities for financial inclusion, i.e. as seen in the progress made in recent years in Zimbabwe (refer

Figure 3: Informally served and excluded consumers). However, a country will not be able to optimise these opportunities unless financial inclusion barriers are addressed, such as AML/CFT due diligence requirements that encourage overly conservative compliance by institutions. Mobile financial services have, in a number of SADC jurisdictions, facilitated a rapid increase in access to underserved and excluded populations. As a point of departure, an enabling regulatory environment is needed in this regard.

The aforementioned increase in access to financial services will have an impact on the lives of large segments of the populations of the countries in question. It is suggested that valuable insights will be gained in tracking this impact in relation to relevant variables, including those relating to economic development and financial integrity.

Figure 4: World Bank regional poverty trends



The statistics contained in the graph on the left relate to the period ended 2011, however, the indications are that poverty levels remain high in the Sub-Saharan Africa region.

Although the proportion of the total population living below the poverty line²¹ (population below \$1.25 a day) is declining, the absolute number of people in this category is increasing. It is reasoned that, in light of the picture indicated above, economic development in the Sub-Saharan Africa region remains a priority, which in turn indicates the importance of financial inclusion friendly AML/CFT requirements in the region. Research relating to the levels of poverty in SADC in relation to identified contributing factors would yield useful insights.

Increasing access to finance and financial services within the SADC region has been identified as an opportunity to contribute towards alleviating poverty and stimulating economic development and growth. The identified barriers to financial inclusion, regulatory and other, should be considered against the picture outlined in the commentary above. Notably, the cost of financial services is crucial to encouraging formal access. Where costs are materially increased as a result of AML/CFT requirements, this will have a detrimental effect on financial inclusion. Due diligence requirements can serve as a barrier to financial inclusion where individuals do not have the documentation required to verify their identity. There are numerous other AML/CFT variables that should be considered in relation to financial inclusion. Consideration thereof is beyond the scope of this report. It is suggested that they could be addressed as part of a SADC study to address financial inclusion and AML/CFT matters. This could be leveraged off the recommendations made in a FinMark Trust initiated and funded report published in 2011 entitled "Conservative compliance behaviour: Drivers of conservative compliance responses in the South African financial services industry".²² These would serve as a starting point and will be relevant in identifying opportunities to develop a regulatory/supervisory environment that is focused on the achievement of AML/CFT and financial inclusion objectives.

²¹ Population below \$1.25 a day is the percentage of the population living on less than \$1.25 a day at 2005 international prices.

²² Recommendations include: Consult with regulated institutions when drafting new laws to ascertain potential compliance responses; Clarify legal obligations; Allow adequate time for the implementation of regulatory requirements; Cooperate with the industry to increase compliance expertise; and Build mutual trust.

5.5. AML/CFT regulatory requirements and financial inclusion

Various studies have indicated that AML/CFT regulatory requirements have a significant impact on individuals that would like to make use of the formal financial system. Notably, the concept of “overly conservative compliance” or “over compliant” responses by institutions was put forward in a FinMark Trust study published in 2011.²³ This identified that business management processes may support conservative compliance responses for a number of reasons, including; an institutional compliance culture, a conservative approach to risk in the industry, a need for uniformity in business management processes, lack of compliance management expertise, foreign compliance examples that inform local compliance responses, concern about penalties and sanctions, the desire to maintain a good relationship with regulators and supervisors, a belief that the supervisor is intolerant of compliance errors, law that is uncertain, appropriate management of other risks that may require a conservative approach, and business information systems that may dictate a conservative response.

There have been instances where a country’s AML/CFT regulatory requirements have allowed for simplified due diligence in certain circumstances, but institutions have not necessarily taken advantage of this, for instance:²⁴ “In certain cases financial institutions adopt processes and procedures that go beyond what is required by applicable regulatory requirements. For example, regulators that allowed financial institutions to adopt simplified customer due diligence measures in respect of low risk customers and products to support greater financial inclusion found that some financial institutions continued to apply more comprehensive measures”. The factors indicated in the preceding paragraph are relevant when considering the reasons for this.

Challenges faced by consumers that are financially excluded include low income levels and rural living circumstances that may not place them in a geographical position that enables or encourages the use of formal financial services. A detailed analysis of the drivers of financial exclusion is beyond the scope of this report. However, the most common reasons for not having a bank account are cited as follows²⁵: Not enough money, do not need an account, family member already has an account, too expensive, too far away, lack of documentation, cannot get an account, lack of trust, and religious reasons.

A number of the aforementioned considerations relate directly to AML/CFT regulatory requirements, specifically in respect of due diligence documentation that is required and the increase in costs of financial services as a result thereof. Due diligence requirements also represent administrative challenges that can ultimately result in compliance risk for institutions.

These challenges have been recognised in research that has been carried out, for example:²⁶ “Absolute barriers prevent persons from using a service. For example, if the regulation requires certain formal documents to be presented, persons without the documents are effectively excluded from the service. Transaction costs, when unaffordable, can also prevent persons from using a service. If the transaction costs imposed on utilising formal sector services are too high, clients are likely to abandon the formal

²³ FinMark Trust. Conservative compliance behaviour: Drivers of conservative compliance responses in the South African financial services industry. Louis de Koker and John Symington. August 2011.

²⁴ FinMark Trust. Conservative compliance behaviour: Drivers of conservative compliance responses in the South African financial services industry. Louis de Koker and John Symington. August 2011. Page 4.

²⁵ World Bank. Global Financial Inclusion (Global Findex) Database 2014: Measuring Financial Inclusion around the World.

²⁶ Genesis. Hennie Bester, Prof Louis de Koker and Ryan Hawthorne. Access to Financial Services in South Africa: A brief case study of the effect of the implementation of the Financial Action Task Force Recommendations. April 2004.

sector and turn to informal sector provision (the informal sector is by definition beyond the reach of regulation and the incremental transaction costs imposed by it). This defeats the very object of imposing the regulation in the first instance, and has negative consequences for the development of the society.”

In view of the sensitivity to cost in the underserved and excluded market, it is recognised that AML/CFT requirements can represent a barrier to entry. Further, the regulatory framework should ideally enable the use of new technologies for access purposes. It is perhaps in this area where the greatest benefits could be derived from regulatory harmonisation. This is indicated in the following: “Historically, the high cost of building and operating traditional bank branches has been a major obstacle for reaching poor customers with financial services. Brick-and-mortar branches are expensive for banks to maintain in far-flung communities, while traveling to urban areas is costly for many rural customers. Digital finance helps providers overcome these barriers ...”²⁷

In view of the identified challenges relating to financial inclusion, the FinMark Trust reviews of the SADC country AML/CFT requirements have focused on whether they are consistent with the following FATF recommendations:

- Customer Due Diligence (CDD) (Recommendation 10);
- Record keeping requirements (Recommendation 11);
- Correspondent banking (Recommendation 13);
- Money or value transfer services (Recommendation 14);
- New technologies (Recommendation 15);
- Wire transfers (Recommendation 16);
- Reliance on third parties (Recommendation 17);
- Internal controls (Recommendation 18); and
- Reporting requirements for suspicious transactions (Recommendation 20).

The indications are that certain regulatory requirements that have been implemented, in respect of the above recommendations, vary from country to country and there are, in some jurisdictions, opportunities to consider the AML/CFT implications thereof from a financial inclusion perspective. This is addressed in the respective focus notes, as listed in section 1 (Introduction) of this document.

5.6. Financial exclusion risk

The identified opportunity to cover financial inclusion considerations relating to AML/CFT regulatory requirements in the SADC countries provides a platform from which to consider the benefits that can be derived from an economic development standpoint. However, at the same time, from an AML/CFT assessment perspective, the risk of financial exclusion should be identified, assessed and understood. Where a high proportion of a country’s consumers are informally served or excluded, this will mean that a high proportion of consumers will fall outside of the formal identification and verification processes that are applied by financial institutions. They may not be subject to risk mitigation processes to the same extent as in the formal sector, which will mean that there will be limited opportunity to identify, assess, understand and monitor ML/TF risks relating to those informally served and excluded.

It follows that the higher the levels of financial exclusion in a country, the greater the potential for increased ML/TF risk as a result of limited opportunities for risk mitigation. The potential impact of financially excluded populations will depend on the size and nature of the informal sectors in the SADC

²⁷ CGAP. <http://www.cgap.org/topics/digital-financial-services>.

countries – from both an economic development potential perspective and an AML/CFT risk assessment viewpoint.

ML/TF risks relating to the informal economy of countries should be subject to disciplined risk assessment processes with a view to understanding the overall risk relating thereto. For example, there should be an appreciation of proceeds of crime that flow into, within and out of the informal sector. Further, it would be beneficial to develop a regional understanding of the level of risk in relation to ML/TF threats and vulnerabilities. This would provide countries with a broad platform from which to frame national as well as institutional level risk assessment. Opportunities for such coordination are, to an extent, seen in Annex 12 that was added to the SADC Protocol of Finance and Investment (FIP) in 2012. This is addressed in Focus Note 5 - Harmonisation of regulatory frameworks in the SADC region.

5.7. Development of regulatory frameworks by countries

It is perhaps fair to say that the initial driver for the development of AML/CFT regulatory frameworks was the need for countries to comply with the FATF Recommendations. These were, to an extent, not put in place with a specific focus on the impact thereon in respect of non-AML/CFT related considerations. Structured (often inflexible) approaches taken by regulators have, in some instances, been conservative and have had an adverse impact on financial inclusion. Challenges have also been identified in respect of flexible risk-based approaches, notably where there are high levels of regulatory uncertainty.

In general, countries in the SADC region did not develop their AML/CFT regulatory frameworks before conducting a full national risk assessment (as envisaged in the revised FATF Recommendations) and requiring institutions to contribute towards this assessment. This means that the respective laws, regulations and supervisory requirements that were brought into effect were, to an extent, based on the country's understanding of the FATF standards rather than on a robust identification, assessment and understanding of country specific ML/TF risks, perhaps most importantly in respect of financial inclusion considerations. Further, it is recommended that an assessment of the ML/TF risks in the SADC region could be undertaken prior to determining the approach that should be undertaken in respect of the design, development and implementation of a regulatory framework in a country. This could inform the methodology applied in each individual jurisdiction. The approach should ideally be designed to provide a sound understanding of local circumstances and position how best to tackle the intersect between financial integrity (avoidance of abuse of the financial system for ML/TF purposes) and financial inclusion (access to finance and financial services).

The Making Access to Financial Services Possible (MAP) initiative has played a role in addressing challenges relating to regulatory requirements.²⁸ An example of the output thereof is seen in the recently announced pilot Lesotho cross-border money transfer project. This is supported by the development of an exemption in terms of the Financial Intelligence Centre Act²⁹ in South Africa that allows for reduced client identification, verification and record keeping requirements when concluding single cross border

²⁸ FinMark Trust has partnered with the United Nations Capital Development Fund (UNCDF) and Cenfri to develop and deliver the MAP initiative. This seeks to advance financial inclusion and support expanding access to an appropriate portfolio of financial services for individuals and micro and small businesses that are either underserved or un-served. An appropriate portfolio of financial services includes effective access to credit, savings, payments and insurance products. These products have the potential to improve the welfare of lower income people by helping to conduct and manage their financial lives more efficiently, increase income, better manage risks and build up wealth over time.

²⁹ Act 38 of 2001.

remittance transactions of funds not exceeding R3000 per day and R10 000 per calendar month.³⁰ The exemption will, in all likelihood, have a positive impact on financial inclusion.

Countries that have AML/CFT regulatory requirements that have been in place the longest are less likely to have a framework that fully embraces a risk-based approach in a manner that conforms with the latest international standards and the current trends in ML/TF risk mitigation. For example, the South African due diligence requirements were brought into effect in 2003, i.e. at time when the risk-based approach was not mandatory. Accordingly, the core legislation³¹ is essentially rules-based and there is a recognised need for amendments to keep pace with recent international developments. At the time that these focus notes were being finalised, the South African regulatory authorities published a draft Financial Intelligence Centre Act Amendment Bill for public comment. The Bill introduces a risk-based approach to customer due diligence and appears to provide room for financial inclusion friendly measures if, for example, ML/TF risk is mitigated in a manner that does not significantly impede access. The following has been indicated by the regulatory authorities relating to the AML/CFT approach that underpins the draft legislation:³² “This approach will simplify the current complex and rules-based system of compliance, by providing financial institutions with the flexibility to determine how they verify their clients’ identity, taking into account the particular circumstances pertaining to that client.”

The draft amendments will provide a basis for a graduated client due diligence methodology. However, they will, by their nature, also mean that there may be high levels of uncertainty relating to what due diligence will meet the regulatory requirements relating to different levels of risk. Regulatory guidance will play a crucial role in this regard. The enablement of such guidance at country, sector or institutional levels should ideally involve private and public sector stakeholders in the interests of achieving regulatory objectives. Further, where there are plans to withdraw the rules-based exemptions (for example exemption 17) to make way for a flexible risk-based approach, an impact analysis should be conducted prior to implementation in order to determine the implications for financial inclusion.

5.8. Conservative AML/CFT responses

There is an increasing realisation that the FATF Recommendations are not necessarily at odds with a financial inclusion policy agenda. The recommendations are, in the main, principle-based and provide countries with the flexibility to implement regulatory frameworks that are appropriate to their circumstances. However, in practice, the reality can be seen quite differently. Countries may adopt inflexible and inclusion unfriendly frameworks, which, when coupled with rigorous supervisory practices, can lead to overly conservative compliance responses by institutions. For example, this is, in some respects, seen in the rules-based regulatory framework that was put in place in South Africa³³, although certain exemptions that were implemented³⁴ have had a positive impact on financial inclusion. Another example can be found in Zambia where hard copies of AML/CFT-related records must be kept (for a minimum of 7 years), regardless of whether an electronic copy is kept.

³⁰ Financial Intelligence Centre. Public Compliance Communication No. 32. July 2015.

³¹ Financial Intelligence Centre Act 38 of 2001 and Gazette 7541 No R 1595 Regulation in Terms of the Financial Intelligence Centre Act, 2001 (Money Laundering and Terrorist Financing Control Regulations, 2002) and the subsequent amendments thereto.

³² The National Treasury and the Financial Intelligence Centre. Media Statement - Request for Public Comments on the Draft Financial Intelligence Centre Amendment Bill, 2015.

³³ Financial Intelligence Centre Act 38 of 2001.

³⁴ For example, exemption 17.

Countries are assessed through a process of peer assessments called the “mutual evaluations” carried out by the FATF community to assess compliance with, and the effective implementation of, the FATF standard at a national level. The FATF’s International Cooperation Review Group (ICRG) considers a jurisdiction’s compliance with the FATF standards and issues statements identifying countries with strategic deficiencies. These statements generally call on FATF members to consider the risks arising from deficiencies in jurisdictions, i.e. in their financial engagements with such countries. In very serious cases, the FATF may advise countries to apply counter-measures to protect the international system from ML/FT risks arising from that country. Institutions in countries that are listed by the ICRG, in this context, may face increased costs of doing international business, termination of business relationships and a slower pace of transactions due to increased due diligence required by counterparts. These measures may impact negatively on the country’s economy in the form of economic sanctioning from peers.

Therefore, the consequences for a country with strategic compliance deficiencies are so severe that many policy makers and regulators have tended to adopt very conservative practices and rules, fearing the punitive measures that may arise, which can adversely contribute towards financial exclusion. The revised 2012 FATF Recommendations attempt to deal with this concern. There is now scope to address the narrow approach that was adopted by certain countries as a result of overly conservative interpretations of the international standard. However, the existing legislation in some SADC jurisdictions is still founded on a conservative approach that was encouraged in the past, which can result in financial exclusion. FATF guidance has recognised the challenges in question: “The promotion of formal financial systems and services is central to any effective and comprehensive AML/CFT regime. However, applying an overly cautious approach to AML/CFT safeguards can have the unintended consequence of excluding legitimate business and consumers from the formal financial system.”³⁵

The FinMark Trust review has revealed that the SADC countries have developed differing AML/CFT regulatory frameworks and there are identified opportunities for regulatory harmonisation. For example, only in South Africa has the Exemption 17 approach been adopted. Refer to Focus Note 2 (risk-based approaches to AML/CFT) for details in this regard. This has provided institutions with a rules-based opportunity to apply simplified due diligence. Various regulatory harmonisation perspectives are covered in the focus notes that follow, however it should be remembered that the full spectrum of factors that impact on the behaviour of institutions should be considered. This will provide a base from which to understand financial inclusion supply side dynamics in an integrated way. In this regard, the factors indicated in section 5.5 above will be relevant. A focus on financial inclusion demand side considerations and the interrelationships between the various AML/CFT stakeholders, particularly between supervisors and institutions, will also provide valuable perspectives.

5.9. Recommendations

Effective co-ordination and communication relating to financial inclusion – Refer to section 5.3 above

Effective co-ordination and communication relating to AML/CFT regulatory requirements, at the highest levels of government between stakeholders that are responsible for financial inclusion and financial integrity policies of a country, will highlight cross-functional challenges with a view to proactively addressing them. This could include formal consultation relating to existing or proposed new AML/CFT-related regulatory requirements by the AML/CFT regulatory authorities with those authorities that are

³⁵ FATF, 2013.

responsible for financial inclusion / economic development in a jurisdiction (could include the Minister of Finance and the Minister of Trade and Industry).

Holistic view of financial inclusion and other variables – Refer to section 5.3 above

The relationship between financial inclusion and other variables that impact on economic development should be viewed in a holistic manner when considering the impact thereof in relation to AML/CFT objectives. These include, for example, the availability and use of technology, levels of education and literacy, new delivery channels, geographic and public/private sector governance variables, to name a few. It is noted that further research in this regard would yield valuable insights.

Risk assessment relating to the informal economy – Refer to section 6 above

The ML/TF risks in the informal economy should be addressed in order to obtain an overall understanding thereof in any particular jurisdiction. For example, in respect of proceeds of crime that flow into, within and out of the informal sector.

Evaluation of the impact of financial inclusion on economic development – Refer to section 6 above

An objective evaluation of the impact of financial inclusion on economic development would provide valuable insights in light of the relationship between financial inclusion and financial integrity objectives. This is perhaps best undertaken with input from financial institutions that are able to provide hands-on practical client-facing AML/CFT due diligence and financial inclusion related input.

Financial exclusion drivers – Refer to section 5.5 above

It is recommended that countries that have low levels of financial inclusion should identify and monitor financial exclusion drivers that arise out of AML/CFT regulatory requirements, with a view to developing an understanding thereof. This will serve as a platform from which to consider financial exclusion risk in the country (particularly where this could adversely affect the overall ML/TF risk in the country).

Design, development and implementation of a regulatory framework – Refer to section 5.7 above

An assessment of the ML/TF risks in the SADC region should ideally be undertaken prior to the design, development and implementation of a regulatory framework in a country, as well as any update or changes thereto. This should be designed to provide a sound understanding of local circumstances and position how best to address the intersect between financial integrity (avoidance of abuse of the financial system for ML and TF purposes) and financial inclusion (access to finance and financial services).

Achievement of regulatory objectives – Refer to section 5.7 above

Answering the question of whether AML/CFT objectives are being achieved in a country goes hand-in-hand with the question of whether a country's AML/CFT framework is effective or not. However, to an extent, it goes further in that the focus on the achievement of objectives means that the outcome thereof on the broad-based population of a country would be considered as a matter of course. Where a country is committed to the achievement of both AML/CFT and financial inclusion objectives, this approach should be encouraged in the SADC countries together with an appropriate focus on the question of whether the country's AML/CFT requirements inappropriately impact on financial inclusion objectives.

Conservative AML/CFT responses – Refer to section 5.8 above

The full spectrum of factors that impact on the behaviour of institutions should be considered. This will provide a base from which to understand financial inclusion supply side dynamics in an integrated way. A focus on financial inclusion demand side considerations and the interrelationships between the various AML/CFT stakeholders, particularly between supervisors and institutions, will also provide valuable perspectives.

5.10. Conclusion

AML/CFT regulatory requirements can have a significant impact on access to financial services by currently excluded and informally served populations in the SADC region. The FinMark Trust review has revealed that the SADC countries have developed differing AML/CFT regulatory frameworks and that there are identified opportunities for regulatory harmonisation. However, in understanding conservative compliance behaviour by institutions, the full spectrum of factors that impact on the behaviour of institutions should be considered, as indicated in section 5.5. The impact of AML/CFT laws should not be viewed in isolation.

It is advisable, in the interests of encouraging financial inclusion and the achievement of financial integrity objectives, for countries to inform the development of their AML/CFT regulatory framework on the back of the output national level ML/TF risk assessments. This should incorporate consideration of financial exclusion risk, bearing in mind the implications thereof from the ML/TF and economic development perspectives.

The intersect between financial integrity objectives and financial inclusion matters should be addressed at a policy level. There should be appropriate communication between stakeholders at the highest policy making level.

6. End-note

The achievement of AML/CFT objectives through the AML/CFT regulatory requirements and the supervision thereof in a manner that does not unduly compromise financial inclusion is a thread that runs through all aspects of this report.

Two overarching opportunities have been identified over the course of the study in this regard, i.e. which could be addressed in further projects:

- Development of a SADC relevant understanding of the application of FATF Recommendations, perhaps with a view to aligning this with relevant specifications contained in the FIP; and
- Undertaking of a SADC supra-national ML/TF risk assessment, perhaps with a view to informing the regulatory approaches that are adopted in SADC countries.

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- Abbreviations/glossary

The following abbreviations are used:

- AML – Anti-Money Laundering
- CFT – Counter Terrorist Financing
- CDD – Customer Due Diligence
- DNFBP – Designated Non-Financial Businesses and Professions

EDD – Enhanced Due Diligence

ESAAMLG – Eastern and Southern Africa Anti-Money Laundering Group

FATF – Financial Action Task Force

FIP – SADC Protocol of Finance and Investment

ICRG – International Cooperation Review Group

MAP – Making Access to Financial Services Possible

ML – Money Laundering

MNO – Mobile Network Operator

OTT – Occasional Transaction Threshold

TF – Terrorist Financing