Does the Financial Action Task Force (FATF) Help or Hinder Financial Inclusion? A Study of FATF Mutual Evaluation Reports

Michael Pisa

Abstract

As the organization responsible for setting international standards on anti-money laundering and countering the financing of terrorism (AML/CFT), the Financial Action Task Force (FATF) has encouraged countries to design measures that protect the integrity of the financial system and support financial inclusion. But it has also received criticism that poor implementation of its standards can undermine financial access. One of the FATF's main tools for compelling effective use of its standards is the mutual evaluation process, which relies on peer reviews to assess countries' level of compliance with the FATF Recommendations. We explore whether these reviews have been conducted in a way that helps or hinders national efforts to promote financial inclusion by reviewing the 33 developing country mutual evaluations that took place between 2015-2018. Overall, these findings suggest that assessment teams have conducted mutual evaluations in a way that supports efforts to promote financial inclusion and the flexible use of simplified measures. There is, however, inconsistency in how assessors treat risks emanating from financial exclusion, which suggests the need for a more systematic approach to evaluating these risks.

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A Study of FATF Mutual Evaluation Reports

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List of Acronyms

AML	Anti-Money Laundering
CDD	Customer Due Diligence
CFT	Combating the Financing of Terrorism
EDD	Enhanced Due Diligence
FI	Financial Institution
FATF	Financial Action Task Force
ML	Money Laundering
MSB	Money Service Business
MVTS	Money or Value Transfer Services (The FATF's preferred term for MSBs)
NPO	Non-Profit Organization
NRA	National Risk Assessment
RBA	Risk-based Approach
SSB	Standard-setting Body
SDD	Simplified Due Diligence
TF	Terrorism Financing

Introduction

Over the last ten years, the Financial Action Task Force (FATF) —the organization responsible for setting international standards on anti-money laundering and countering the financing of terrorism (AML/CFT) — has encouraged countries to design measures that "protect the integrity of the financial system, while at the same time support and facilitate financial inclusion."[1]

Supporting financial inclusion became a priority for the FATF in the late 2000s as the organization became more attuned to the money laundering (ML) and terrorism financing (TF) risks associated with financial exclusion and the advantage of bringing more people into the formal financial system where transactions can be more easily monitored — and as the international community began to pay more attention to the economic benefits of financial access.

In 2011, following a multi-year review process, the FATF published guidance that recognized financial inclusion and financial integrity as mutually reinforcing objectives.[2] A year later, the organization revised its standards (i.e., the FATF Recommendations) to strengthen and emphasize the risk-based approach (RBA) as the "essential foundation" of a country's AML/CFT framework.[3] Crucially for financial inclusion, the RBA allows financial institutions to use simplified Customer Due Diligence (CDD) (or simplified due diligence – SDD) measures for customers that present a lower risk profile, which reduces the cost of bringing them into the formal financial sector.

The FATF's commitment to the RBA was welcomed by the financial inclusion community, as illustrated by comments made by Queen Máxima of the Netherlands, the Honorary Patron of the G20's Global Platform for Financial Inclusion (GPFI) in 2013:

> In just three years, we have come from a situation where financial integrity was seen as a barrier to financial inclusion to the situation today where there is a general recognition that financial inclusion, financial integrity, and financial stability are not only compatible, but also mutually reinforcing. FATF has time and again recognized this objective, which has paved the way for notable actions in many countries. FATF's new recommendations do hold the potential to bring many more people into the formal financial system without compromising the [FATF's] purpose of combating financial crime. And by doing this, they also greatly reduce risks associated with financial exclusion.

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[1] FATF. "*FATF Guidance: Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion – With a Supplement on Customer Due Diligence*." FATF: Paris. 2013-2017.

[2] ibid

[3] FATF. *International Standards on Combatting Money Laundering and the Financing of Terrorism & Proliferation*. FATF: Paris. 2012.

But even as the FATF received praise for its commitment to the RBA, it faced criticism that ineffective implementation of its standards had made it more difficult for a growing number of money service businesses (MSBs), small banks, and non-profit organizations (NPOs), including many in the developing world, to access financial services.[4]

Concerns about ineffective implementation of the FATF standards highlight the greater responsibility that the RBA places on national supervisors and financial institutions to adequately assess the ML/TF risks they face and respond appropriately. Doing this well is especially difficult in countries with limited technical capacity and expertise. Critics contend that supervisors and financial institutions in some developing countries, wary of crossing a regulatory redline, have erred on the side of caution by implementing laws and company policies that are more stringent than those required by the FATF. The result, they argue, is a culture of rigid, non-risk-based "overcompliance" that makes it more difficult to provide financial services to the poor.[5]

Financial inclusion expert Louis de Koker highlighted this risk at a speech in 2012:

> The FATF's RBA can be very helpful in removing FATF-related barriers to financial inclusion. Underlying this approach, however, is an assumption that institutions will assess risks correctly and adopt simplified CDD when risks are assessed as low. The large-scale closure of accounts of Money Service Businesses by banks in response to often unfounded risk concerns has shown that this is not necessarily the case. Conservative institutions tend to overestimate risk and avoid it or adopt over-designed controls. Conduct of regulators and supervisors, such as harsh compliance enforcement action, may exacerbate this behavior. Adoption of simplified CDD measures is optional, but if institutions fail to do so when appropriate, financial inclusion can be undermined and financial exclusion risk would rise.[6]

The FATF has repeatedly tried to convey the flexibility inherent in its standards in order to reduce overcompliance — including most recently in a 2017 supplement that provides examples of how countries and financial institutions use simplified CDD measures to meet

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[4] For more detail on these trends, see the 2015 Center for Global Development report on the Unintended Consequences of Anti–Money Laundering Policies for Poor Countries.

[5] For example, Bank for International Settlements: Committee on Payments and Market Infrastructures. *Correspondent Banking*. 2016. Pg. 12.

World Bank Group. *Withdrawal From Correspondent Banking Where, Why, And What To Do About It*. Washington, DC. 2015. Pg. 29.

John Howell & Co. Ltd. *Drivers & Impacts of Derisking*. Surrey, UK. February 2016. Pg. 15.

Durner, Tracy and Liat Shetret. *Understanding Bank Derisking And Its Effects On Financial Inclusion: An Exploratory Study*. November 2015. Pg. 6.

[6] Washington Journal of Law, Technology & Arts. *Symposium: Mobile Money In Developing Countries: Financial Inclusion And Financial Integrity*. University of Washington School of Law. Vol. 8. No. 3. 2013.

their financial inclusion goals — but there is still a perception that some national supervisors and financial institutions are unable or unwilling to implement a truly risk-based approach.[7]

Beyond issuing standards and guidance, one of the FATF's main tools for encouraging effective implementation of its standards is the mutual evaluation process, which uses a system of peer reviews to assess countries' level of technical compliance with the FATF Recommendations and the effectiveness of their AML/CFT systems.[8]

In this paper, we examine 33 developing country mutual evaluation reports published to date in the current (4th) round of mutual evaluations to determine:

(1) How and to what extent they take financial inclusion and exclusion into consideration in assessing the effectiveness of a country's AML/CFT regime and what types of recommendations these considerations lead to; and
(2) How assessors evaluate countries' SDD measures (or the absence of such measures) and what this indicates about the flexibility the FATF gives to countries in designing these policies.

We supplement our document review with information gathered through over twenty interviews with financial inclusion experts, FSRB officials, and financial supervisors in several developing countries.[9]

Limitations of the Approach

Before previewing our findings, it is important to note the limitations of both our aims and approach. To be clear, our goal is not to judge whether the teams that carry out mutual evaluations were correct or not in their assessments and recommendations, since doing so would require access to the same information provided to them, much of which is not publicly available.

Doing so would also require insight into the conversations that took place between assessors and country officials in the process of reviewing a country's risks and developing the scoping note that sets out the high-priority areas that the evaluation will focus on, since it may be the case that concerns about financial exclusion were raised, and adequately dealt with, at this stage.

The context-specific nature of the mutual evaluations also limits our ability to determine why some reports focus more on financial inclusion than others. As the FATF has stressed, "under the RBA, the AML/CFT requirements implementing the country's approach to

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[7] FATF. 2013-2017. "*FATF Guidance: Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion – With a Supplement on Customer Due Diligence*." FATF: Paris.
[8] FATF. 2013-2018. "*Methodology for Assessing Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems*." Updated November 2018. FATF: Paris.
[9] We list the experts interviewed in Appendix 1 except for several who asked to remain on background.

financial inclusion must be evaluated on a case-by-case basis, depending on the specific country's risk context at a given moment."[10]

Finally, it is worth emphasizing that because the FATF's mandate is to set standards and promote effective implementation of measures "for combating ML, TF, and other related threats" and because the mutual evaluations are intended to focus only on high-priority risks in a country, we should only expect assessors to focus on financial inclusion in cases where they view financial exclusion as a high-priority risk.

While these limitations are real, they do not prevent us from exploring questions such as why different assessment teams treat financial inclusion and exclusion differently in countries with similar levels of financial access and proceeds-generating crime, or why the identification of financial exclusion risk leads to recommendations to improve financial access in some countries but not others. In effect, we can report patterns, but only speculate about causation.

Key Findings

The key takeaways from our research are:

Financial Inclusion and Exclusion in the Mutual Evaluation Reports

- Nearly all the reports in our review included some discussion of financial inclusion and exclusion but there was a large variation in the depth of coverage.
- Consistent with the mutual evaluation methodology, the degree to which assessors paid attention to financial inclusion was strongly correlated with the degree to which they saw financial exclusion as a risk.
- There was less consistency, however, around the identification of financial exclusion risk itself. In most countries where the assessors identified a low-level of financial inclusion and a high degree of informality, they raised concerns about financial exclusion risk, but not all.
- Six out of the 33 the reports had at least one priority action related to expanding financial access or better understanding the risks of the informal sector.
- Despite the FATF's stance that financial institutions can exacerbate financial exclusion risk when they implement overly conservative ML/TF controls, we found only two cases in which assessors expressed concern about overcompliance on the part of financial institutions, except in relation to the non-profit sector. (Box 2)
- We identified more than ten cases in which assessor teams judged that a country's AML/CFT policies towards non-profits in some way hindered their legitimate activity. Non-profits received more attention in the reports than any other issue related to

[10] FATF. 2013-2017. "*FATF Guidance: Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion – With a Supplement on Customer Due Diligence*." FATF: Paris.

financial inclusion, probably because the FATF requires assessors to consider how TF rules affect the sector. (Box 3)

Simplified Due Diligence (SDD) in the Mutual Evaluation Reports

- In most cases, the assessment teams conducted evaluations in a way that supports the use of SDD measures. This includes multiple instances in which the assessors urged countries to adopt or expand the use of SDD measures and several in which they chose not to criticize national supervisors or financial institutions for implementing far-reaching and novel measures to improve financial access.

- In addition, in several countries the assessors called on national authorities to work with financial institutions to encourage the use of risk-based SDD measures.

Overall, these findings suggest that assessment teams have conducted mutual evaluations in a way that supports efforts to promote financial inclusion and the flexible use of SDD measures. One area of concern, however, is the apparent inconsistency in how assessors treat risks emanating from financial exclusion — and what this means for the recommendations they make. This finding echoes the concern raised by the GPFI in 2016 that although standard-setting bodies, including the FATF, had taken important steps to support financial inclusion, "little progress had been made on understanding financial exclusion risks."[11] The absence of such knowledge makes it harder for national authorities to design policies that preserve financial integrity and support financial inclusion.

Recommendations

Based on the findings of our research, we offer three recommendations on ways the FATF could further strengthen its support for financial inclusion.

1. *Develop a structured framework for measuring and understanding financial exclusion risk*. Given the apparent inconsistency around the treatment of financial exclusion risk, the FATF should take steps to ensure that assessment teams routinely and systematically consider the issue when conducting a mutual evaluation. For that reason, our primary recommendation is a re-endorsement of the GPFI's 2016 advice for the FATF and other standard-setting bodies to develop a structured framework that would help assessors and policymakers better understand the drivers and risks associated with financial exclusion.[12] Ideally, the development of this framework would be carried out in

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[11] de Koker, Louis, Kate Lauer, and Timothy Lyman. *Deepening Insights on Financial Exclusion Risks*. Consultative Group to Assist the Poor. June 9, 2016.
Global Partnership for Financial Inclusion. *Global Standard-Setting Bodies and Financial Inclusion: The Evolving Landscape*. March 2016. Washington, DC.

[12] The GPFI made these recommendations in its report Global Standard-Setting Bodies and Financial Inclusion: The Evolving Landscape: (1) Work towards the development of a common understanding of the risks of financial exclusion. This will help the SSBs to assess the impact of financial exclusion on the policy objectives of financial stability, integrity, and consumer protection and to understand the relevance of financial exclusion to the mandates and work of the individual SSBs. While such an understanding is a precondition for commonly accepted assessments of financial exclusion risk levels globally, regionally, and at a

collaboration between FATF and financial inclusion experts from organizations like the Alliance for Financial Inclusion, the Consultative Group to Assist the Poor (CGAP), and the GPFI.

2. *Strengthen assessor training and expand staffing to take financial exclusion risks into account more consistently.* In addition to developing a structured framework to guide assessors and policymakers in evaluating financial exclusion risks, the FATF should also ensure that its assessors understand the issue well. It could do so this most easily by highlighting the issue in its assessor training materials and classes, but it could go a step further by requiring each assessment team to include a financial inclusion expert. If the costs of doing so are prohibitive, the FATF could instead develop a small cadre of financial inclusion experts that would review each mutual evaluation report to ensure consistent coverage and treatment of financial exclusion risks and recommendations to address them.[13]

3. *Require assessors to encourage the use of SDD measures unless there is good reason not to.* Given the emphasis that the FATF has placed on the importance of SDD measures for expanding financial access and considering the apparent inconsistency in the treatment of financial exclusion across mutual evaluations, the organization should require its assessors to examine whether SDD measures would be appropriate in countries where the approach is not established, and in cases where there is low risk. If after conducting this review, assessors determine that ML/TF risks are too high or that a country's technical capacity is too low to justify the use of SDD measures, they should state this explicitly in the evaluation report.[14]

A Brief History of the FATF and Financial Inclusion

The FATF was established in 1989 with the aim of combating money laundering related to drug trafficking. The organization broadened its focused in the 1990s to encompass money laundering more generally and revised its mandate after the September 11th attacks to include

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national level, it is an ambitious undertaking given the current state of knowledge. An initial step would be a comprehensive SSB-by-SSB analysis of challenges posed by financial exclusion to the pursuit of each SSB's mandate. And (2) Explore development of a framework to assess the impact of financial sector regulation, supervision, enforcement, and institutional compliance practices on financial exclusion risks and their mitigation. A common understanding of the risks of financial exclusion will allow work to begin exploring the development of such a framework. An initial step could be jointly undertaken country case studies, perhaps within the context of SSB outreach bodies and regional consultative bodies. The next step could be the development of processes for collecting quantitative and qualitative data to track changes in financial exclusion risk levels. The data can be used to help inform financial sector policies at the country level and standards and guidance at the global level. Global Partnership for Financial Inclusion. *Global Standard-Setting Bodies and Financial Inclusion: The Evolving Landscape*. March 2016. Washington, DC.

[13] Thanks to Christopher Calabria, a senior advisor at The Bill & Melinda Gates Foundation, for making this recommendation.

[14] For a discussion on certain circumstances in which SDD should not be implemented. See de Koker, Louis and John Symington. *Conservative Corporate Compliance: Reflections On A Study Of Compliance Responses By South African Banks*. Law in Context. Volume 30 (2014).

countering the financing of terrorism. Today, the FATF's stated objectives are to "set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system."[15]

At the time of its creation, the FATF's membership was limited to G-7 Member States, the European Commission, and eight other high-income countries. Over time, its membership has expanded to include 36 high- and middle-income countries, two regional bodies (the European Commission and the Gulf Co-operation Council) and a global network of FATF-Style Regional Bodies (FSRBs) composed of and representing mostly developing countries (We list the FSRBs in Box 1).[16]

Over 190 countries have endorsed the FATF's standards for AML/CFT, which take the form of its 40 Recommendations. Although the FATF is a soft law organization that lacks authority to enforce legal sanctions against non-compliant states, it has achieved great success in promulgating its standards due in large part to its mutual evaluation process and its practice of black- and grey-listing countries found to be non-compliant with the Recommendations.

FATF and Developing Countries

In the early years of its existence, the FATF restricted its focus on the policies of its own (mostly rich) members. That changed in the late 1990s, as policymakers began to account for the increasingly globalized nature of the financial system and with it, of illicit financial flows. According to this perspective, the global AML/CFT system is "only as strong as the weakest link in the chain" since criminals can "simply avoid countries with tough AML standards by re-routing their finances through countries that had no such laws."[17]

Taking a more global outlook led the FATF to begin monitoring the AML/CFT policies of non-member countries and expand its network by establishing the FSRBs, most of which were formed between 1997 and 2004.[18] But expanding its remit raised new challenges for the organization, which now had to encourage the implementation of its standards in less developed countries with larger informal sectors and lower levels of technical capacity and regulatory expertise.

Whereas the FATF could take financial access for granted in the high-income countries it had previously focused on, the situation was different in developing countries, where only 42 percent of the population had an account at a formal financial institution in 2011 (compared to 88 percent in high-income countries).[19] The large size of the informal sector and more

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[15] FATF. 2018. "*What We Do*."

[16] Two other countries — Indonesia and Saudi Arabia — have observer status, as do several international organizations. FATF. 2018. "*FATF Members and Observers*."

[17] Sharman, Jason. 2008. "Power and Discourse in Policy Diffusion: Anti-Money Laundering in Developing States." International Studies Quarterly. Volume 52, Issue 3: p. 13.

[18] The exception is the Caribbean Financial Action Task Force (CFATF), which formed in 1992.

[19] Ansar, Saniya, Jake Hess, Leora Klapper, Asli Demirguc-Kunt, Dorothe Singer. *The Global Findex Database 2017*. World Bank Group. Washington, DC. 2018.

frequent use of unregulated channels to transfer money in many developing countries made it more difficult to effectively monitor and prevent illicit financial behavior. According to the FATF, "informal, unregulated and undocumented financial services and a pervasive cash economy can generate significant money laundering and terrorist financing risks and negatively affect AML/CFT preventive, detection and investigation/prosecution efforts."[20]

Lower levels of supervisory capacity also made it more difficult for developing countries to adopt the FATF standards. A 2008 study by the FIRST Initiative, found that the introduction of AML/CFT controls adversely impacted access to and usage of financial services in five developing countries (Indonesia, Kenya, Mexico, Pakistan, and South Africa).[21] Similarly, a 2011 IMF study concluded that "compliance with the AML/CFT standard is low" and that "compliance is correlated with the countries' economic development."[22] The FATF sought to address the issue in its 2008 *Guidance on Capacity Building for Mutual Evaluations and Implementation of the FATF Standards Within Low Capacity Countries.*[23]

The combination of low supervisory capacity and large informal economies in many developing countries raised the risk that efforts to implement AML/CFT rules there would push legitimate financial activity out of the formal financial sector into the informal cash economy, or prevent it from entering in the first place, resulting in "financial exclusion" that made it had harder to monitor transactions.

In addition to growing awareness within the FATF that financial exclusion could increase ML/TF risks, there was also growing pressure from outside actors concerned about how AML/CFT rules were affecting efforts to expand financial access, including the G-20, which in 2010 highlighted the importance of financial inclusion in its Leaders' Communique and created the Global Partnership for Financial Inclusion (GPFI) to carry forward work on the topic.[24]

The first public indication of a shift in thinking within the FATF came in 2009 in a speech by FATF President Paul Vlaanderen in which he emphasized that "the pursuit of financial inclusion and the pursuit of an effective AML/CFT regime are complementary; they are by no means conflicting financial sector policy objectives."[25]

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[20] FATF. *FATF Guidance: Anti-money laundering and terrorist financing measures and Financial Inclusion*. FATF. Paris. 2011.

[21] Bester, H., D. Chamberlain, L. de Koker, C. Hougaard, R. Short, A. Smith, and R. Walker. *Implementing FATF Standards In Developing Countries And Financial Inclusion: Findings And Guidelines*. The FIRST Initiative. Washington, D.C. May 2008.

For more on the FIRST Initiative see: https://www.firstinitiative.org/

[22] Yepes, Concepcion Verdugo. *Compliance with the AML/CFT International Standard: Lessons from a Cross-Country Analysis*. IMF Working Paper 11/177. International Monetary Fund: Washington, DC, p. 6. 2011.

[23] Financial Action Task Force. *Guidance On Capacity Building For Mutual Evaluations And Implementation Of The Fatf Standards Within Low Capacity Countries*. FATF: Paris. February 29, 2008.

[24] The Global Partnership for Financial Inclusion (GPFI). *About GPFI*.

[25] The first use of the "complementarity" frame appears to be: Bester, H., D. Chamberlain, L. de Koker, C. Hougaard, R. Short, A. Smith, and R. Walker. *Implementing FATF Standards In Developing Countries And Financial Inclusion: Findings And Guidelines*. The FIRST Initiative. Washington, D.C.. May 2008.

In 2012, the FATF Ministers, who are responsible for setting the organization's mandate, stated that financial exclusion represented "a real risk to achieving effective implementation" and that "many countries – particularly those with capacity constraints – continue to face legitimate challenges in achieving effective implementation of the FATF Recommendations."[26]

The framing of financial integrity and financial inclusion as complementary aims would serve as the foundation of the FATF's approach from 2011 onward, first in its guidance on *Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion* (which was further updated in 2013), then in its Recommendations, which the organization revised in 2012 to establish the RBA as the established as the "essential foundation" of a country's AML/CFT framework, and finally in its mutual evaluation methodology, which it revised in 2013 to increase the focus placed on the effectiveness of a country's AML/CFT framework.

The FATF's Revised Approach to Support Financial Inclusion

The core idea behind the RBA is that it allows countries "to adopt a more flexible set of measures in order to target their resources more effectively and apply preventive measures that are commensurate to the nature of risks, in order to focus their efforts in the most effective way."[27]

As a first step in applying the approach, the FATF calls on countries to "identify, assess, and understand" the ML/TF risks they face (a requirement which most countries meet by conducting a national risk assessment) and develop appropriate countermeasure to address those risks. Once a country has conducted a risk assessment, the FATF instructs that "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" (italics ours). [28]

The ability of national supervisors to implement simplified measures is a key component of the RBA and an important tool for financial inclusion. As the FATF has recognized, "identifying and verifying the identity of potential customers is, in practice, the main

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See also Isern, Jennifer and Louis de Koker. *AML/CFT: Strengthening Financial Inclusion and Integrity*. CGAP. 2009.

The mutuality of AML/CFT and financial inclusion objectives was also a theme of U.S. Assistant Treasury Secretary Daniel L. Glaser's Keynote Address for the US-India Private Financial Sector Dialogue in Mumbai, India in July 2011.

[26] FATF. *Ministers renew the mandate of the Financial Action Task Force until 2020*. FATF. Washington, DC. 2012.

[27] FATF. *Guidance for a Risk Based Approach: The Banking Sector*. FATF. Paris. Updated October 2014.

[28] FATF. 2012. "*International Standards on Combatting Money Laundering and the Financing of Terrorism & Proliferation*." FATF: Paris, p. 11. Updated October 2016.

challenge met by financial institutions when seeking to on-board previously unbanked, unserved, or underserved people." [29]

For that reason, the FATF has focused its financial inclusion efforts on encouraging national authorities to simplify their due diligence requirements for low-income customers — usually by requiring less documentation to open accounts that have restricted balances or limited functionality — when there is a proven low risk of ML/TF, based on an adequate risk analysis by the country or financial institution. The FATF justifies the use of such measures on the grounds that "newly banked and vulnerable groups often conduct a limited number of basic, low value transactions" and therefore "may present a lower ML/TF risk." [30]

Early evidence suggests that the use of simplified measures can improve financial access. For example, Mexico reported that the number of bank accounts in the country increased by 9.1 million (or 14 percent) in the two years after it introduced its tiered KYC scheme.[31] Of these newly opened accounts, 77 percent were accounts opened with SDD.

Assessing Effectiveness

Whereas earlier mutual evaluations focused solely on the degree to which a country's AML/CFT regime was in technical compliance with the regulations, the FATF's revised mutual evaluation methodology introduced in 2013 called on assessors to determine to what degree that regime was effective in mitigating ML/TF activity.[32]

The primary purpose of the effectiveness assessment is to ensure that countries are allocating their scarce AML/CFT resources to effectively address their ML/TF risks. For example, a country with thin capital markets that devotes a high proportion of its resources to ML/TF risk in that sector, while shortchanging other areas, would be considered ineffective use of resources.[33]

The effectiveness component also directed assessors to consider the size of the informal sector and financial exclusion as factors that could influence the effectiveness of a country's AML/CFT regime. As noted by Lyman and Noor (2014), this meant that it would be possible for a country's AML/CFT regime to be judged technically compliant but nonetheless ineffective if its requirements were so onerous that they undermined access to the formal financial system for legitimate purposes. The authors hoped that this would

[29] FATF. 2012. "*International Standards on Combatting Money Laundering and the Financing of Terrorism & Proliferation*." FATF: Paris, p. 11. Updated October 2016.

[30] FATF. *FATF Guidance: Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion*. FATF: Paris. 2013.

[31] Faz, Xavier. *Mexico's Tiered KYC: An Update on Market Response*. CGAP. June 25, 2013.

[32] FATF. 2013-2018. "*Methodology for Assessing Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems*." FATF: Paris. Updated November 2018.

[33] Lyman, Timothy and Wameek Noor. *AML/CFT and Financial Inclusion: New Opportunities Emerge from Recent FATF Action*. CGAP. Pg. 18. September 2014.

incentivize national authorities to focus more on financial inclusion in their risk assessments and AML/CFT strategies.[34]

Where Are We Now?

Determining whether the RBA and the assessment of effectiveness has been successful in promoting financial inclusion is a difficult task. In the RBA's favor, many countries have adopted SDD measures (at least on paper) since the FATF revised its standards in 2012: a recent World Bank survey reported that 60 countries now allow exemptions or simplifications to CDD for certain types of customers or products.[35] In addition, financial access in the developing world continues to improve at a respectable pace, with the share of adults with an account at a formal financial institution growing from 42 percent in 2011 to 63 percent in 2017.[36]

At the same time, however, several experts and officials we interviewed reported that national supervisors in developing countries continue to implement laws that are not risk-based and impose more stringent account opening requirements for low-income and low-risk persons or products than those required by the global standards, due to uncertainty over how to implement the RBA and fear of being publicly identified for shortcomings in their AML/CFT framework.

For example, many countries continue to require extensive documentation for opening a bank account, even though the FATF has not established specific requirements for documentation and allows countries to use simplified measures commensurate with risk:[37] According to the World Bank's 2017 Global Financial Inclusion and Consumer Protection (FICP) Survey of 124 jurisdictions: 75 percent required proof of address to open an account; 69 percent required proof of nationality or legal status; 44 percent required proof of income; and 35 percent required proof of employment.[38]

Even when national supervisors put SDD measures in place, financial institutions may not make use of them. The FATF has acknowledged this, noting that financial institutions sometimes "go beyond the requirements of relevant laws and regulations…by deciding not to implement simplified due diligence measures where allowed…or closing accounts due to a lack of understanding of the law."[39]

Lyman, Timothy and Wameek Noor. *AML/CFT and Financial Inclusion: New Opportunities Emerge from Recent FATF Action*. CGAP. Pg. 18. September 2014.

[35] World Bank Group. *Global Financial Inclusion and Consumer Protection Survey, 2017 Report*. Washington, D.C. Pg. 27-28. 2017.

[36] Ansar, Saniya, Jake Hess, Leora Klapper, Asli Demirguc-Kunt, Dorothe Singer. *The Global Findex Database 2017*. Washington, DC. 2018.

[37] FATF. 2013-2017. "*FATF Guidance: Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion – With a Supplement on Customer Due Diligence*." FATF: Paris. November 2017.

[38] It is important to note that jurisdictions may be imposing these requirements for purposes other than AML/CFT, such as anti-corruption and tax collection. Data source: World Bank Group. *Global Financial Inclusion and Consumer Protection Survey, 2017 Report*. World Bank Group: Washington, DC: pp. 27-28. 2017.

[39] FATF. *Guidance for a Risk-Based Approach: Money or Value Transfer Services*. FATF: Paris. February 2016.

The FATF Mutual Evaluation Process – A Brief Overview

The FATF has taken a more proactive role in promulgating its standards than any other standard setting body.[40] A key element of the organization's approach is the mutual evaluation process, which it introduced in 1991, replacing its original self-assessment and self-reporting system for monitoring implementation. These peer reviews assess each country's level of technical compliance with the FATF Recommendations and the effectiveness of their AML/CFT system.

The FATF is now in the midst of its fourth round of mutual evaluations, which runs from 2014 to 2024 and is the first round of reviews to evaluate countries for effectiveness against the revised 2012 FATF Recommendations, using the revised 2013 assessment methodology. To date, 70 mutual evaluation reports have been published in this round, of which 33 have focused on developing countries.[41]

Each mutual evaluation takes about 14 months to complete and is carried out according to strict guidelines outlined in a 172-page document (see Figure 1 for an overview of the process).[42] The FATF assesses roughly 40 mostly high-income FATF-member countries, while FSRB member countries are assessed by staff from the FSRBs, often in collaboration with experts from the IMF and World Bank.[43]

Once an assessment team has been formed, it first reviews the country's AML/CFT risks and context. ML/TF risks considered include the level and type of proceeds-generating crime in the country, terrorist groups active or raising funds in the country, and exposure to cross-border flows of criminal or illicit assets. The team must also develop an understanding of context, including the character of a country's economy and financial sector, the amount of domestic vs. cross-border business and financial transactions, the degree to which the economy is cash-based, the size of the informal sector, and the extent of financial inclusion. Context also includes the country's AML/CFT laws and regulations and other structural elements, such as political stability, rule of law, and various other factors that could influence the way AML/CFT measures are implemented and how effective they are.

Once the assessors have developed an understanding of the country's key ML/TF risks and context, they prepare a scoping note — in consultation with the country being assessed — that outlines the areas on which the effectiveness component of the evaluation will focus.[44] The assessment team then travels to the country under review for on-site meetings with public officials and private sector actors to examine how AML/CFT laws work in practice. This effectiveness assessment is guided by eleven "immediate outcomes" (IOs) intended to capture the objectives to be achieved by implementing the global standards. Following the

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[40] Lyman, Timothy and Wameek Noor. *AML/CFT and Financial Inclusion: New Opportunities Emerge from Recent FATF Action*. CGAP. September 2014.

[41] We use the term "developing countries" to refer to jurisdictions identified by the World Bank as low or lower-middle income countries.

[42] FATF. Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems. FATF: Paris. 2019.

[43] FATF. *Frequently Asked Questions – Mutual Evaluations*. FATF: Paris. 2018. Accessed on December 30, 2018.

[44] FATF. *Procedures For The FATF Fourth Round Of AML/CFT Mutual Evaluations*. FATF: Paris. 2018.

on-site visit, the assessors finalize a draft of the report that is shared with country officials for initial discussion of the report findings and recommendations. The FATF Evaluations and Compliance Group reviews each draft report for consistency before sending it to the Plenary for final approval.

After the report is adopted and published, the country under review is expected to address any identified shortcomings and is subject to post-assessment monitoring.[45] According to the FATF, the completion of the assessment and publication of the report is merely "a starting point for the country to continue strengthening its measures to tackle money laundering and terrorist financing."[46]

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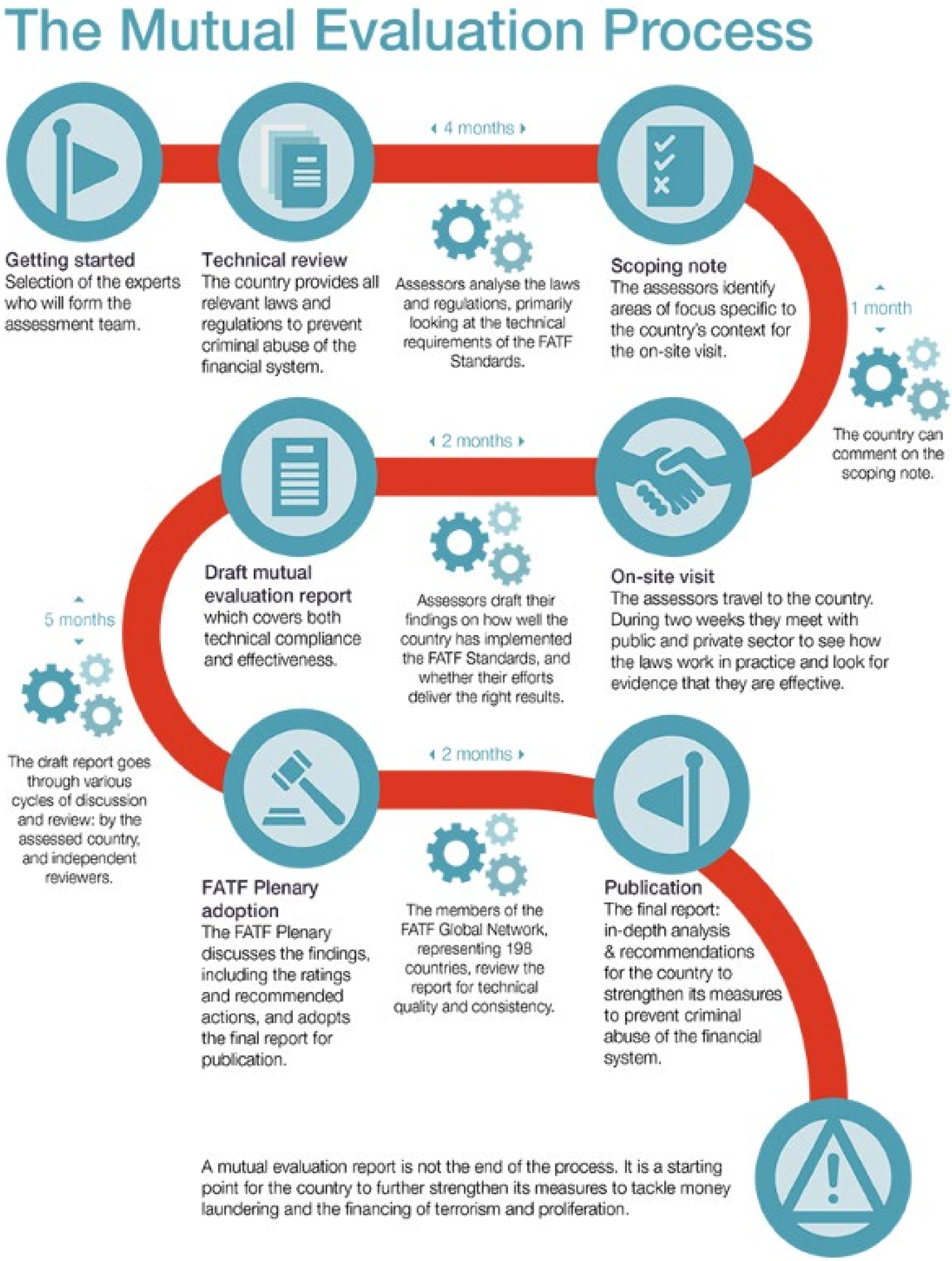
[45] Financial Action Task Force. *Topic: Mutual Evaluations*.

[46] ibid

Figure 1.



Source: http://www.fatf-gafi.org/publications/mutualevaluations/more/more-about-mutual-evaluations.html?hf=10&b=0&s=desc(fatf_releasedate)

A Review of Developing Country Mutual Evaluation Reports

To better understand whether the FATF mutual evaluation process has been conducted in a way that supports national financial inclusion efforts, we review the 33 developing country mutual evaluation reports that have taken place since 2014 to examine:

(1) How and to what extent the assessment teams take financial inclusion and exclusion into consideration in assessing a country's AML/CFT regime and what types of recommendations these considerations lead to; and

(2) How assessors evaluate countries' SDD measures (or the absence of such policies) and what this indicates about the flexibility the FATF gives to countries in designing these measures.

Treatment of Financial Inclusion

All mutual evaluation reports follow the same basic template and tend to cover issues related to financial inclusion in the same sections. We focus our analysis in three areas: (1) the treatment of financial exclusion as a factor influencing the effectiveness of a country's AML/CFT regime; (2) priority actions and other recommendations related to financial inclusion broadly; and (3) the treatment of SDD measures in particular, given their importance for financial inclusion. We also highlight how assessors have dealt with several other issues related to financial inclusion in a series of boxes, including overcompliance by financial institutions (Box 2); risk-based supervision of non-profit organizations (NPOs) (Box 3), mobile money (Box 4), and digital ID (Box 5).

How Financial Exclusion Influences the Effectiveness of a Country's AML/CFT Regime

The first chapter of every mutual evaluation ("ML/TF Risks and Context") establishes the nature and extent of the ML/TF risks that a country faces and the country context, broadly considered. The discussion of context lays out *material* factors, such as "the makeup of the economy and the financial sector," as well as broader *structural* and *contextual* factors that might affect the effectiveness of the country's AML/CFT regime, such as institutional integrity, political stability, and corruption.[47]

As part of this exercise, the FATF directs assessors to consider "the level of financial exclusion" as a *contextual* factor that could influence the effectiveness of the country's AML/CFT regime and "estimates of the size of the informal sector and/or shadow economy" as a *material* factor to determine the relevance of different FATF Recommendations.[48] Because the evaluations are intended to focus only on high-priority

[47] FATF. 2013-2018. *Methodology for Assessing Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems*. FATF: Paris, pp. 6-7. Updated November 2018.

[48] FATF. 2013-2018. *Methodology for Assessing Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems*. FATF: Paris, pp. 6-7. Updated November 2018.

risks in a country, the level of attention that each report pays to financial inclusion and exclusion will depend on whether the assessors believe that financial exclusion presents a significant ML/TF risk.

Nearly all the reports we reviewed include some discussion of financial inclusion and exclusion.[49] In most, however, the analysis of these issues is brief and may merit just a short paragraph that cites data from the World Bank's Global Findex on account ownership and mentions the level of informality in a country's economy. This is the case in **Honduras (2016)**, for example.[50] In other reports, the discussion of countries' financial exclusion challenges and the policies their governments have devised to deal with them are substantial. This is the case in **Bangladesh (2016)** and **Myanmar (2018)** among others. [51]

Consistent with the evaluation methodology, the degree to which assessors paid attention to financial inclusion in the reports was strongly correlated with the degree to which they saw financial exclusion as a risk.

There was less consistency, however, around the identification of financial exclusion risk. In most countries where the assessors identified both a low-level of financial inclusion and a high degree of informality, they raised concerns about financial exclusion risk. This was especially the case when the assessors also identified a high-level of proceeds-generating crime.

For example:

- In **Ethiopia (2015)**, where 35 percent of adults have a financial account, the assessment team stated that "financial exclusion remains a significant issue for Ethiopia with approximately 72% of the population having no access to the formal financial sector, and thereby depending fully on cash transactions or illegal (or unlicensed) provision of MVTS and money exchange services" and elsewhere highlighted the risks associated with "human trafficking, smuggling and corruption.'"

- In **Costa Rica (2015)**, the assessors noted that "the situation of informal activities in Costa Rica seems to be a concern" and warned that the country's "level of financial exclusion and the lack of a policy to order financial inclusion efforts" created "significant concern." More broadly, the assessors highlighted the importance of financial inclusion more than ten times in the report — even though

[49] The exception was Jamaica (2017) which does not discuss issues related to financial inclusion, exclusion, or the informal economy. FATF. *Anti-money Laundering And Counter-terrorist Financing Measures: Jamaica*. FATF: Paris. January 2017.

[50] GAFILAT (Financial Action Task Force of Latin America). "*Anti-Money Laundering and Counter-terrorist Financing Measures – Republic of Honduras, Fourth Round Mutual Evaluation Report*." GAFILAT: Buenos Aires, p. 25. 2016. World Bank. *The Little Data Book on Financial Inclusion 2018: Honduras*. Washington, DC. 2018.

[51] APG (Asia/Pacific Group on Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures – Bangladesh, Third Round Mutual Evaluation Report*. APG: Sydney, pp. 20-21. 2016.
APG (Asia/Pacific Group on Money Laundering) *Anti-Money Laundering and Counter-Terrorist Financing Measures – Myanmar, Third Round Mutual Evaluation Report*. APG: Sydney, pp. 23-24, 27-28, and 86-87. 2018

the country had the highest level of inclusion in the region (with 50 percent of adults having a financial account at the time of the report).

- In **Mexico (2018)**, the assessors noted that "with high regional rates of migration, a sizable informal economy (23.6 percent of GDP), low financial inclusion, weak border controls, and high-volume smuggling of USD, Mexico faces a significant challenge in detecting criminal from licit flows." The assessors then "explored the extent to which the country's policies on financial inclusion and AML/CFT are coordinated and the implications of the former for the latter." (we discuss the treatment of Mexico's approach to SDD below)

- In **Bangladesh (2016)**, the assessors noted that the government had "pursued a strong policy focus on financial inclusion to support continuing movement from informal cash-based systems to formal transaction-based economic activity"

But there were exceptions to this general rule. In some countries, the assessors noted a high degree of informality but did not discuss financial exclusion or inclusion. For example:

- In **Honduras (2016),** where only 45 percent of adults have a financial account (compared to the LMIC average of 58 percent), the assessors noted "a high component of informality" and "high rates" of organized crime and corruption in public institutions but made no mention of the risks raised by exclusion and discussed financial inclusion only in passing.

Elsewhere, the assessors did not consider the risks of financial exclusion despite high levels of informality and low levels of financial access. For example:

- In **Cambodia (2017)**, where only 22% percent of adults have a formal financial account, the assessors highlighted the government's strategy to promote financial inclusion as a poverty reduction tool, but did not consider risks related to informality and financial exclusion, except to note that "there has been no assessment made to determine the size of the informal financial sector in Cambodia."

Comment

As noted above, we cannot determine why assessors chose to emphasize certain risks over others or whether these decisions were well-founded because we do not have access to the same information they received or insight into the conversations that took place during the evaluation. Furthermore, countries with the same degree of inclusion and informality can have very different ML/TF risks.

But the apparent inconsistency of how assessors treat financial exclusion risk raises concerns and suggests the need for a more structured approach. This need was highlighted in 2014 by Lyman and Noor, who noted that "the nature and extent of financial exclusion risk has yet to be systematically studied" and argued that a lack of understanding of these risks made it harder for national authorities to design policies aimed at balancing financial integrity and financial inclusion goals.

Building on their work, in 2016 the GPFI called on financial standard-setting bodies, including the FATF, to work "towards the development of a common understanding of the risks of financial exclusion" and create a "framework to assess the impact of financial sector regulation, supervision, enforcement, and institutional compliance practices on financial exclusion risks and their mitigation."[52] Little progress has been made on this proposal, however, and we are unaware of any initiatives underway to create such a framework.

Priority Actions and Other Recommendations Related to Financial Inclusion

Each mutual evaluation report contains a list of priority actions in its executive summary that highlight the assessment team's key recommendations.[53] In cases where the assessors believe that financial exclusion (or more broadly, the level of informality) poses a significant threat to the effectiveness of a country's AML/CFT regime, they may recommend that national authorities prioritize financial inclusion efforts.

6 of the 33 developing countries reports in our sample included priority actions focused on expanding financial access or better understanding the risks of informality.[54] In most cases, priority actions related to financial inclusion are explicitly linked to the risks posed by financial exclusion.

- In **Ethiopia (2015)**, the assessment team recommended that the government prioritize the expansion of financial inclusion generally:

> "***Expand financial services to the unbanked and those without access to financial services.*** Given the very high percentage of the population that is without access to financial services, and the estimated very high volumes of transactions taking place in cash, unrecorded and untraceable, it will be important to ensure that the efforts of the NBE and the (public) financial sector to expand access, by offering low value accounts through traditional banks and through micro-finance institutions, be maintained and further strengthened. In addition, the efforts of the national government to promote financial inclusion should be coordinated closely with AML/CFT authorities to ensure that ML/FT risks are considered and managed in this context."

- In **Madagascar (2018)**, where only 18 percent of adults have an account with a formal financial institution, the assessment team made a similar recommendation:

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52 Global Partnership for Financial Inclusion. *Global Standard-Setting Bodies and Financial Inclusion: The Evolving Landscape*. Washington, DC. March 2016.

53 FATF. 2013-2018. *Methodology for Assessing Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems*. Updated November 2018.

54 Note that we do not include here general recommendations to implement a risk-based approach that do not explicitly refer to financial inclusion or financial exclusion, though some would argue that any recommendation to implement an RBA could be interpreted as serving financial inclusion goals.

"***Implement measures to ensure a wider use of the banking system and improve financial inclusion***. These actions must also aim at combating informality and include two components: an incentive component to lead the actors operating in the informal sector to enter the formal regulated sector, and a repressive component to fight against the operators who would continue to practice in the informal sector."

- In **Albania (2018),** the assessors noted that "the large size of the informal economy in Albania, combined with the still widespread use of cash, constitutes a significant ML vulnerability" and urged authorities to enhance their understanding of how the informal economy affects ML/TF risks.
- In **Nicaragua (2017),** the report's first priority action was for the authorities to enhance their understanding of ML/TF risks, in part, by incorporating an "analysis on how informality and financial exclusion levels affect the global risk assessment."
- Likewise, **Guatemala (2017)** was urged to conduct a review of terrorist financing risk analysis, including "the role of the informal economy that causes lack of transaction control and has an impact on the calculation of TF risk."
- In **Sri Lanka (2015),** the report encouraged authorities to "take measures including issuing guidance to FIs to encourage the implementation of simplified CDD for certain products, particularly in sectors identified as lower risks in support of financial inclusion." Elsewhere in the document they noted the authorities' "commendable work in evaluating existing financial inclusion products."

Financial inclusion is often the subject of less-prioritized recommendations made throughout the report documents. We provide a few examples here and discuss recommendations specifically linked to SDD in the next section.

- In **Albania (2018)**, the assessors noted that "the large informal economy makes reasonable identification of ML/TF risks and pursuit of cases very challenging."[55] They recommended, in addition to the priority action discussed above, that the authorities "add to the existing measures targeting the informal economy [including] . . . promotion of financial inclusion."[56] They also noted that, "in devising further policies to promote financial inclusion, the assessment team encourages authorities to pay particular attention to ensuring that AML/CFT requirements do not have an overly restrictive effect on access to the formal financial system."[57]

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[55] MONEYVAL (Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Albania, Fifth Round Mutual Evaluation Report*. MONEYVAL: Strasbourg, p. 33. 2018.
[56] MONEYVAL (Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism). 2018. "*Anti-Money Laundering and Counter-Terrorist Financing Measures: Albania, Fifth Round Mutual Evaluation Report*." MONEYVAL: Strasbourg, p. 29.
[57] MONEYVAL (Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Albania, Fifth Round Mutual Evaluation Report*. MONEYVAL: Strasbourg, p. 33. 2018.

- In **Costa Rica (2015)**, the assessors concluded that "the levels of financial exclusion and the lack of formal financial inclusion policies at a country level are of special concern and could have a significant impact in the AML/CTF system." They recommended that "at a country level, the current draft policies and regulations should be completed to promote financial inclusion, also taking into consideration the relevance of the financial exclusion factor in the framework of AML/CFT policies, and being compatible and proportionate with the efforts of the money laundering preventive system while promoting the introduction of specific regulations regarding products aimed at financially including the population, including matters related to ML/TF risks."[58]

- In **Myanmar (2018),** the assessors recommended that that the authorities "ensure that financial sector regulators and supervisors develop a deeper understanding of risk and vulnerability issues, in particular informal sector (cash economy, hundi), financial inclusion, dollarization, etc…)."

We identified only one report, **Zimbabwe (2016),** in which the assessors identified informality of the economy as presenting a risk but did not make recommendations to address it.[59]

Comment

Unsurprisingly, the likelihood that a report includes recommendations about expanding financial access was much higher in countries where the assessment team saw financial exclusion as a significant risk. Conversely, the level of financial inclusion by itself did not predict whether assessors issued recommendations aimed at improving financial access. For example, in Cambodia, the assessors made no recommendations related to financial exclusion despite the country's low level of financial inclusion and their observation that "there has been no assessment made to determine the size of the informal financial sector in Cambodia."

Again, we can only speculate about the reason for this disparity. It could be that the assessment team for Cambodia judged government authorities' current financial inclusion policies to be adequate, or that they determined that other areas were higher priorities. Inconsistent treatment of financial exclusion risks and the recommendations that emanate from them could also reflect differences in the composition of each assessment team, which would naturally lead to different approaches to prioritization. Regardless of the reason, the

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[58] GAFILAT (Financial Action Task Force of Latin America). *Anti-Money Laundering and Counter-terrorist Financing Measures – Republic of Costa Rica, Fourth Round Mutual Evaluation Report*. GAFILAT: Buenos Aires, p. 82. 2015.

[59] The assessors noted that the "the [Zimbabwe] economy increasingly became highly cash-intensive and informal, as citizens shunned the formal economy. This ultimately led to a number of unrecorded transactions which leave no "paper trail" necessary [sic] for any monitoring or investigation by competent authorities. This situation potentially raised the country's exposure to ML/TF risks."
The Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG). *Anti-money Laundering and Counter-terrorist Financing Measures: Zimbabwe*. Dar es Salaam, United Republic of Tanzania. September 2016.

apparent inconsistency again suggests the need for a more structured framework that guides assessors and national authorities in considering financial exclusion risk.

Treatment of Simplified Due Diligence (SDD) Measures

In its technical guidance, the FATF directs the teams conducting mutual evaluations to determine whether countries that have enacted SDD measures have justified and "properly supported" them through a risk assessment. [60] Notably, although the methodology does not explicitly call on assessors to consider whether SDD measures would be appropriate in cases where national authorities have not pursued them, some assessor teams do so.

Assessment of SDD Measures

Most assessments of SDD tend to fall into one of several categories:

- The country has not applied SDD.
    - For example, in **Mongolia (2017)**, the assessors reported that "the findings of the NRA have not led to implementation of enhanced or simplified AML/CFT measures or to any exemptions from AML/CFT requirements for lower risk activities."
- The country has applied SDD measures that are supported by the country's risk assessment. For example:
    - In **Mexico (2018)**, the assessors determined that the anonymous Tier I accounts, which were introduced as a financial inclusion policy and to bring pre-paid cards into the AML/CFT regulatory framework, "[did] not seem to be a major deficiency, given the very low average balance and the small size of the funds held in these accounts" and that "the exemptions seem to be broadly appropriate given the identified ML/TF risks."[61] This finding is significant because *FATF Recommendation 10* states that "financial institutions should be prohibited from keeping anonymous accounts."[62]
    - In **Bangladesh (2016)**, the assessors determined that the country's simplified measures were "based on low risk and . . . are well supported by risk assessments."[63]
    - In **Indonesia (2018)**, the assessors reported that "Indonesia has a proactive approach to promoting financial inclusion. . . AML/CFT preventive regulations

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[60] FATF. 2013-2018. "*Methodology for Assessing Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems*." FATF: Paris, pp. 8-9. Updated November 2018 (additional revisions adopted during the October 2018 Plenary).

[61] FATF and GAFILAT (Financial Action Task Force of Latin America). *Anti-Money Laundering and Counter-terrorist Financing Measures – Mexico, Fourth Round Mutual Evaluation Report*. FATF: Paris, p. 163. 2018.

[62] FATF. 2012. *International Standards on Combatting Money Laundering and the Financing of Terrorism & Proliferation*. Updated October 2018. FATF: Paris.

[63] APG (Asia/Pacific Group on Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Bangladesh: Mutual Evaluation Report*. APG: Sydney, p. 36. 2016.

provide for simplified CDD where risk is demonstrated to be lower, and some banks have introduced savings accounts for financial inclusion with appropriate risk-mitigation measures, e.g. maximum transaction amounts."[64]

- The country has applied SDD, but the measures are not sufficiently supported by the country's risk assessment, or financial institutions have adopted SDD without adequately considering the risks:
  - In **Thailand (2017)**, the assessors determined that the country's risk assessments were "insufficient to support the application of enhanced measures for higher-risk scenarios, or simplified measures for lower risk scenarios."[65]
  - In **Ghana (2017)**, the assessors observed that "not all financial institutions that have adopted SDD measures have undertaken research or analysis to support the adoption of SDD."[66]
  - In **Malaysia (2015)**, the assessors recommended that the authorities "review and as necessary update the sectoral guidelines in line with the NRA findings by focusing on the risk-based provisions with respect to simplified and enhanced measures."[67]
  - In some cases, countries were criticized for adopting SDD based on FATF's standards alone, and without regard to their own NRA, if one had been conducted. This was the case, for example, in **Armenia (2016)**.[68]
  - In **Serbia (2016),** the assessors said that SDD measures were "broader than allowed by the FATF standards."[69] More specifically, they noted that the use of simplified measures for wire transfers were "not based on a low risk specified in the NRA or in any other assessment of risk," and that "during the on-site visit the evaluation team encountered situations where customers were classified by reporting entities as low risk contrary to the findings of the NRA."[70]

Of special interest, and indicating a degree of flexibility greater than what the FATF's critics might expect, in **Botswana (2017)**, the assessors noted without criticism that although

[64] APG (Asia/Pacific Group on Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures – Indonesia, Third Round Mutual Evaluation Report*. APG: Sydney, pp. 20-21. 2018.

[65] APG (Asia/Pacific Group on Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Thailand: Mutual Evaluation Report*. APG: Sydney, p. 38. 2017.

[66] GIABA (Inter-Governmental Action Group against Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Ghana, Second Round Mutual Evaluation Report*. GIABA: Dakar, p. 69.

[67] APG (Asia/Pacific Group on Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures – Malaysia, Third Round Mutual Evaluation Report*. APG: Sydney, p. 43. 2015.

[68] MONEYVAL (Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Armenia, Fifth Round Mutual Evaluation Report*. MONEYVAL: Strasbourg, p. 32. 2015.

[69] MONEYVAL (Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Serbia, Fifth Round Mutual Evaluation Report*. MONEYVAL: Strasbourg, pp. 35, 40, and 44-45. 2016.

[70] Ibid, pg. 44-45

Botswana's legal and regulatory framework did not explicitly provide for SDD, "[financial institutions] have taken some steps to relax the rigidity of the requirements by allowing simplified CDD measures where the customer is allowed to produce other information as form of identification as an alternative to the prescribed ones." The assessors described the example of MSBs allowing refugees to identify themselves with refugee documentation instead of a passport, as is normally required.[71]

SDD-Related Recommendations

In cases where countries have not applied SDD, some reports recommend they pursue it, but not all. In several reports, the assessors recommended that the authorities conduct and distribute risk assessments to support both enhanced and SDD measures or make better use of the NRA's findings.

  - In **Bhutan (2016)**, the assessors recommended that the authorities "disseminate the completed NRA to all reporting entities to support the application of enhanced measures for higher risk scenarios, or simplified measures for lower risk scenarios, and to the broader community.[72]
  - In **Cambodia (2017)**, the assessors recommended that the authorities use the NRA's findings to "apply enhanced measures for higher risk situations, or to justify exemptions, or simplified measures for lower risk situations."[73]
  - In **Mauritius (2018)**, the assessors recommended that the authorities "ensure that simplified measures and exemptions on the application of AML/CFT measures are based on a proper assessment and adequate analysis of ML/TF risks."[74]

- In several developing-country reports, the assessors urged the authorities more directly to adopt or expand the use of SDD:
  - In **Costa Rica (2015)**, the assessors recommended among their priority actions that the authorities should "analyze the establishment of differentiated guidelines and directives for each regulated market, as per the ML/TF risks, setting strengthened and SDD measures, as the case may be."[75]

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[71] ESAAMLG (Eastern and Southern Africa Anti-Money Laundering Group). *Anti-Money Laundering and Combating the Financing of Terrorism: Botswana Second Round Mutual Evaluation Report*. ESAAMLG: Dar es Salaam, p. 88. 2017.

[72] APG (Asia/Pacific Group on Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Bhutan: Mutual Evaluation Report*. APG: Sydney, p. 29. 2016.

[73] APG (Asia/Pacific Group on Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Cambodia: Mutual Evaluation Report*. APG: Sydney, p. 31. 2017.

[74] ESAAMLG (Eastern and Southern Africa Anti-Money Laundering Group).*Anti-Money Laundering and Combating the Financing of Terrorism: Mauritius Mutual Evaluation Report*. p. 39. 2015.

[75] GAFILAT (Financial Action Task Force of Latin America). *Mutual Evaluation Report of the Republic of Costa Rica*. GAFILAT: Buenos Aires, p. 12 and 82. 2015.

- In **Sri Lanka (2015)**, the assessors recommended among their priority actions that "the supervisory authorities should take measures including issuing guidance to financial institutions to encourage the implementation of simplified CDD for certain products, particularly in sectors identified as lower risks in support of financial inclusion."[76]
- In **Botswana (2015)**, the assessors linked SDD directly to financial inclusion, advising that "the authorities should continue working with the financial sector to ensure that transactions are conducted within the formal financial sector by ensuring that they apply a risk-based approach (e.g., simplified CDD measures) to implementation of the AML/CFT measures."[77]
- In **Ethiopia (2015)**, the assessors recommended that "once Ethiopia has established this understanding of ML/FT risks, some efforts to support financial inclusion to consider include enabling financial institutions to apply simplified CDD for low risk/low value financial services products, or providing guidelines on the acceptable identification documents to conduct the CDD process."[78]
- In **Ghana (2017)**, the assessors recommended that the authorities "Accelerate the promotion of financial inclusion by amongst other things: (i) designing SDD measures for specific financial inclusion products for low risk individuals still excluded from the formal financial system, (ii) enhancing initiatives in the field of mobile money services, and/or strengthen the activities and the regime applicable to microfinance institutions, (iii) ensuring that KYC obligations are tailored to the real risks of the various financial inclusion products/services, (iv) ensuring that financial institutions' decisions to apply SDD are based on underlying assessment or analysis of risks, (v) issuing appropriate guidelines, and taking other measures to [ensure that financial institutions] properly understand the risks of financial inclusion products and effectively apply SDD."[79]

- **Serbia (2016)** was the only case we identified in which the assessors explicitly recommended scaling back SDD measures. More specifically, they recommended that "the ability in the law for reporting entities to adopt simplified measures should

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[76] APG (Asia/Pacific Group on Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Sri Lanka, Third Round Mutual Evaluation Report*. APG: Sydney, p. 8. 2015.

[77] ESAAMLG (Eastern and Southern Africa Anti-Money Laundering Group). *Anti-Money Laundering and Combating the Financing of Terrorism – Botswana, Second Round Mutual Evaluation Report*. ESAAMLG: Dar es Salaam, p.27. 2017.

[78] World Bank Group and ESAAMLG (Eastern and Southern Africa Anti-Money Laundering Group). *Anti-Money Laundering and Combating the Financing of Terrorism: The Federal Democratic Republic of Ethiopia Mutual Evaluation Report*. Dar Es Salaam, United Republic of Tanzania. Pg. 58. 2015.

[79] GIABA (Inter-Governmental Action Group against Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Ghana, Second Round Mutual Evaluation Report*. GIABA: Dakar, p. 62-63. May 2017.

be reconsidered and legislative action taken so that these measures are consistent with the FATF Standards and risk."[80]

Comment

In most cases, assessment teams conducted evaluations in a way that supported the use of SDD. This includes eight instances in which the assessors urged countries to adopt or expand the use of SDD measures and several in which they did not criticize a country's national supervisors (Mexico) or financial institutions (Botswana) for implementing far-reaching and novel measures to improve financial inclusion. These findings suggest that FATF may consistently grant national supervisors more flexibility in implementing SDD than many believe.

In addition, several assessment teams (e.g. Botswana, Ethiopia, and Sri Lanka) called on national authorities to work with financial institutions to encourage the use of risk-based SDD measures. This is important since some financial institutions can be reluctant to make use of SDD measures, even when laws allow them to.

It is worth noting that the analysis of SDD measures focused narrowly on the question of whether those measures were backed by a risk assessment, without considering whether they were designed and implemented in a manner that effectively advanced financial inclusion. While undertaking such an assessment is beyond the scope of mutual evaluations, the assessors could call on national authorities working with financial inclusion experts to carry out such an assessment, in cases where financial exclusion is deemed a risk.

How FATF Can Further Promote Financial Inclusion

The FATF deserves credit for the steps it has taken to support financial inclusion, including its promotion of the RBA and the introduction of the effectiveness component into its assessment methodology. As the GPFI has noted, the FATF has gone further in incorporating financial inclusion considerations into its assessment methodology than any other standard-setting body.[81]

Our review also suggests that mutual evaluations have been conducted mutual evaluations in a way that supports efforts to promote financial inclusion and the flexible use of SDD measures.

There is still a perception, however, that AML/CFT rules represent a barrier to financial inclusion and that too many national supervisors in the developing world remain uncertain

[80] MONEYVAL (Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Serbia, Fifth Round Mutual Evaluation Report*. MONEYVAL: Strasbourg. 2016.

[81] Global Partnership for Financial Inclusion. *Global Standard-Setting Bodies and Financial Inclusion: The Evolving Landscape*. Washington, DC. Pg. xvi. March 2016.

about how to best implement the RBA. We offer the following three ideas on ways the FATF could further strengthen its support for financial inclusion:

Recommendations

Based on the findings of our research, we offer three recommendations on ways the FATF could further strengthen its support for financial inclusion.

1. *Develop a structured framework for measuring and understanding financial exclusion risk.* Given the apparent inconsistency around the treatment of financial exclusion risk, the FATF should take steps to ensure that assessment teams routinely and systematically consider the issue when conducting a mutual evaluation. For that reason, our primary recommendation is a re-endorsement of the GPFI's 2016 advice for the FATF and other standard-setting bodies to develop a structured framework that would help assessors and policymakers better understand the drivers and risks associated with financial exclusion. Ideally, the development of this framework would be carried out in collaboration between FATF and financial inclusion experts from organizations like the Consultative Group to Assist the Poor (CGAP) and the GPFI.

2. *Strengthen assessor training and expand staffing to take financial exclusion risks into account more consistently.* In addition to developing a structured framework to guide assessors and policymakers in evaluating financial exclusion risks, the FATF should also ensure that its assessors understand the issue well. It could do so this most easily by highlighting the issue in its assessor training materials and classes, but it could also go a step further by requiring each assessment team to include a financial inclusion expert. If the costs of doing so are prohibitive, the FATF could instead develop a small cadre of financial inclusion experts that would review each mutual evaluation report to ensure consistent coverage and treatment of financial exclusion risks and recommendations to address them.

3. *Require assessors to encourage the use of SDD measures unless there is good reason not to.* Given the emphasis the FATF has placed on the importance of SDD measures for expanding financial access and considering the apparent inconsistency in the treatment of financial exclusion across mutual evaluations, the organization should require its assessors to examine whether SDD measures would be appropriate in countries where the approach is not established, and in cases where there is low risk. If after conducting this review, assessors determine that ML/TF risks are too high or that a country's technical capacity is too low to justify the use of SDD measures, they should state this explicitly in the evaluation report.

Conclusion

Over the last decade, the FATF has taken important steps to help countries implement robust AML/CFT rules while supporting financial inclusion. But it can and should do more, as poorly implemented AML/CFT rules continue to present a barrier to expanding financial access.

The reality, however, is that the FATF remains (rightly) focused on its mandate of combatting money laundering and terrorism financing and is unlikely to give financial inclusion higher priority without significant and consistent pressure from outside actors. And while the FATF has a responsibility to ensure that its standards do not create unnecessary barriers to financial inclusion, it is up to national authorities to develop the policies that advance it.

Box 1. The Nine FATF-Style Regional Bodies (FSRBs)

- Asia/Pacific Group on Money Laundering (APG) based in Sydney, Australia;
- Caribbean Financial Action Task Force (CFATF) based in Port of Spain, Trinidad and Tobago;
- Eurasian Group (EAG) based in Moscow, Russia;
- Eastern & Southern Africa Anti-Money Laundering Group (ESAAMLG) based in Dar es Salaam, Tanzania;
- Central Africa Anti-Money Laundering Group (GABAC) based in Libreville, Gabon;
- Latin America Anti-Money Laundering Group (GAFILAT) based in Buenos Aires, Argentina;
- West Africa Money Laundering Group (GIABA) based in Dakar, Senegal;
- Middle East and North Africa Financial Action Task Force (MENAFATF) based in Manama, Bahrain;
- Council of Europe Anti-Money Laundering Group (MONEYVAL) based in Strasbourg, France (Council of Europe).

Box 2. Financial Institutions' ML/TF Controls and their Effects on Financial Inclusion

Considering the risk that overcompliance by financial institutions can create a barrier to financial access, FATF's methodology allows assessors to consider how domestic financial institutions' ML/TF controls may affect financial inclusion but does not require them to do so, unless financial exclusion is deemed a significant risk.[82]

We identified only three reports in our sample that examine the effect of financial institutions' ML/TF controls on financial inclusion.

- In **Malaysia (2015)**, the assessors reported that some banks avoided doing business with MSBs but stopped short of making any related recommendations. They wrote: "In some instances, supervised reporting institutions have shown a preference for avoiding business with certain high-risk customers (for example, some MSB providers), rather than applying graduated measures or enhanced CDD. This is a challenge for financial inclusion."[83]

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[82] Immediate Outcome 4 (IO4) of the Effectiveness Assessment: "Financial institutions and DNFBPs adequately apply AML/CFT preventive measures commensurate with their risks, and report suspicious transactions." Among the specific factors that FATF suggests assessors could consider in determining whether the outcome has been achieved, one example is: "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?" In FATF's mutual evaluation report template, IO4 is assessed in Chapter 5: "Preventative Measures." In addition, in FATF's 2014 guidance on applying the risk-based approach to banking, it stated "supervisors should also consider issuing guidance to banks on how to comply with their legal and regulatory AML/CFT obligations in a way that fosters financial inclusion."

[83] APG (Asia/Pacific Group on Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures – Malaysia, Third Round Mutual Evaluation Report*. APG: Sydney, p. 96. 2015.

- In **Indonesia (2018)**, the assessors noted the ways in which certain MSBs would strive to serve customers on whom they could not complete their due diligence procedures: "Some money or value transfer services [MVTS] providers would still proceed with processing the remittance payment without complete enhanced due diligence (EDD) and file a suspicious transaction report. In terms of financial inclusion, MVTS is a major channel for Indonesia migrant workers abroad to send money home and there is a need to strike a balance legal compliance and the needs of the underserved. During the onsite visit, the MVTS provider stated that they would ask for a letter from the customer's neighbor as a fallback CDD measure to verify the identity of the customer."[84]
- In **Ukraine (2017)**, the assessors noted the reluctance by domestic banks to service NPOs (discussed further in Box 4).

Comment

The lack of attention paid by assessors to overcompliance is somewhat surprising given the FATF's position that overly conservative measures can exacerbate financial exclusion and increase overall ML/TF risk. It suggests that assessors may be unwilling to criticize financial institutions for taking a conservative or overly rigid approach to managing ML/TF risks.

Box 3. Risk-Based Supervision and Non-profit Organizations (NPOs)

Accessing financial services can be challenging for NPOs, particularly those that operate in areas perceived to be high risk.[85] Unlike in other areas where FATF guidance *allows but does not require* assessment teams to consider how ML/TF regulations affect financial inclusion, FATF *requires* assessors to determine whether regulations to prevent terrorist financing imposed on domestic NPOs impede their ability to legitimately operate.[86]

This requirement was incorporated into the assessment methodology in 2016 after the FATF revised its standards on the NPO sector (Recommendation 8) to state that "not all NPOs are inherently high risk (and some may represent little or no risk at all)."[87] Until that time, the

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[84] APG (Asia/Pacific Group on Money Laundering) *Anti-Money Laundering and Counter-Terrorist Financing Measures – Indonesia, Third Round Mutual Evaluation Report*. APG: Sydney, p. 77. 2018.

[85] Eckert, Sue, Kay Guinane, and Andrea Hall. *Financial Access for U.S. Non-Profits.* Charity and Security Network. February 2017.

[86] Immediate Outcome 10 (IO10) of the Effectiveness Assessment: "Terrorists, terrorist organizations and terrorist financiers are prevented from raising, moving and using funds, and from abusing the NPO sector." For IO10, one of the "core issues to be considered in determining if the Outcome is being achieved" is Core Issue 10.2: "To what extent, without disrupting or discouraging legitimate NPO activities, has the country applied focused and proportionate measures to such NPOs which the country has identified as being vulnerable to terrorist financing abuse, in line with the risk-based approach?" Among the specific factors that FATF suggests assessors could consider in determining whether the outcome has been achieved, one example is: "To what extent are the measures being applied focused and proportionate and in line with the risk-based approach such that NPOs are protected from terrorist financing abuse and legitimate charitable activities are not disrupted or discouraged?"

[87] FATF. 2013-2018. *Methodology for Assessing Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems*. FATF: Paris. Updated November 2018.

FATF had characterized NPOs as being "particularly vulnerable" to terrorist abuse, which critics claimed had "led to overregulation and inappropriate restrictions on NPOs, hampering their legitimate and essential work around the world."[88]

12 reports in our sample identified inappropriate or overly-broad regulations that unduly burdened the domestic NPO sector and recommended that government authorities refine their approach. We list these instances in Appendix 3 and summarize the findings here:

- In some reports, assessors found that the authorities did not understand the NPO sector's risk profile, which prevented them from applying a targeted approach. This was the case in **Armenia (2016)**, **Botswana (2017)**, **Mauritius (2018)**, **Nicaragua (2017)** and **Zimbabwe (2017).**
- In others, assessors found that the relevant laws and regulations were excessively restrictive or inappropriately applied to all NPOs. This was the case in **Albania (2018)**, **Bangladesh (2016)**, **Cambodia (2017)**, **Ethiopia (2015)**, **Indonesia (2018)**, **Mexico (2018)** and **Uganda (2016).**
- In one case (**Ukraine 2018**), assessors found that banks were overly conservative in their compliance practices, in that they applied EDD indiscriminately or refused to serve NPOs at all.
- Every evaluation team that raised concerns about treatment of the NPO sector also included a recommendation to rectify the situation, except **Cambodia (2017),** where the assessors commented on the restrictiveness of laws applying to NGOs but did not explicitly recommend that authorities change their approach.

Comment

Most of the reports that judged that a country's AML/CFT policies towards NPOs in some way hindered their legitimate activity were published after the FATF changed its guidance on NPOs in 2016. It seems likely that the FATF's requirement for assessors to focus on NPOs explains why the sector received significantly more attention in the reports than any other issue related to financial inclusion.

Box 4. Treatment of National ID Systems and Digital ID

The FATF recognizes the importance of robust national ID systems, noting in its 2017 financial inclusion guidance that "one of the main financial integrity challenges in a financial inclusion context is the lack of reliable identity documentation and data verification for potential customers."[89]

In its financial inclusion guidance, FATF stated that "developments on the digitalization of national ID systems and availability of e-KYC can facilitate smooth, low-cost, and reliable

[88] Financial Action Task Force. *NPOs Applaud Important Changes in Financial Action Task Force (FATF) policy – NPOs No Longer Considered "Particularly" Vulnerable*. Brussels, Belgium. June 29, 2016.

[89] FATF. 2013-2017. *FATF Guidance: Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion – With a Supplement on Customer Due Diligence*. FATF: Paris, p. 29.

ID identification and verification," though it also noted that despite a number of national initiatives, "a substantial impact has yet to be seen."[90]

We identified several instances in which assessors discussed national identification issues, either praising countries' efforts in this area or encouraging them to do more. Examples include:

- In **Bangladesh (2016)**, the assessors noted that "the centralized national identification database helps banks to verify CDD and there is good cooperative work in the sector to support initiatives to assist with verification of identity data."[91]
- In **Bhutan (2016)**, the assessors praised the country's national biometric ID system, calling it "a key strength . . . [that] provides a solid foundation for undertaking CDD . . . and is a key element of Bhutan's ongoing actions on financial inclusion.[92]
- In **Ethiopia (2015)**, the assessors recommended that "given that the lack of a verifiable identification system or mechanism at a national or local level complicates the ability of individuals to have access to financial services, Ethiopia should consider developing a mechanism for all citizens that could help facilitate access to formal financial services."[93]
- In **Ghana (2017)**, the assessors recommended, as a priority action, that Ghana "improve [its] identification and verification infrastructure," and offered a list of measures to pursue this objective.[94]
- In **Malaysia (2015)**, the assessors reported that the country's national identity card (NRIC) system "provide a strong element of identification during CDD processes" but that paradoxically "the strength of the national identity card system may have contributed, to some extent, to an over-reliance on this identity point in CDD processes."[95]
- In **Myanmar (2018)**, the assessors reported that among the country's financial inclusion challenges were problems and policy decisions associated with the country's National Registration Card, including the fact that many people—including those belonging to

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[90] FATF. 2013-2017. *FATF Guidance: Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion – With a Supplement on Customer Due Diligence*. FATF: Paris, p. 29.

[91] APG (Asia/Pacific Group on Money Laundering) *Anti-Money Laundering and Counter-Terrorist Financing Measures – Bangladesh, Third Round Mutual Evaluation Report*. APG: Sydney, p. 79. 2016.

[92] APG (Asia/Pacific Group on Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures – Bhutan, Mutual Evaluation Report*." APG: Sydney, pp. 9, 19, 52, and 54. 2016.

[93] World Bank Group and ESAAMLG (Eastern and Southern Africa Anti-Money Laundering Group). *Anti-Money Laundering and Combating the Financing of Terrorism: The Federal Democratic Republic of Ethiopia, Mutual Evaluation Report*. ESAAMLG: Dar es Salaam, p. 58. 2015.

[94] GIABA (Inter-Governmental Action Group against Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Ghana, Second Round Mutual Evaluation Report*. GIABA: Dakar, pp. xiii, 62, and 69. 2017.

[95] APG (Asia/Pacific Group on Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures – Malaysia, Third Round Mutual Evaluation Report*. APG: Sydney, p. 97. 2015.

minority and stateless groups—are not allowed to obtain one, and that alternative ID certificates used by these groups are being discontinued.[96]

- In **Uganda (2016)**, the assessors reported that domestic financial institutions found it challenging "to comply with their KYC and CDD obligations due to the lack of national identity cards in Uganda." They advised authorities to "continue to roll out the National Identity Card project so as to assist and facilitate effective implementation of customer identification and verification obligations as required by Recommendation 10."[97]
- In **Zimbabwe (2016)**, the assessors merely noted that the country "has a good basic identification system for natural and legal persons and arrangements for purposes of performing basic CDD procedures," though it faced other CDD challenges."[98]

Box 5. Treatment of Mobile Money

The FATF has recognized the importance of mobile money to financial inclusion, noting that "in emerging markets forms of mobile money, including mobile payments, are growing and contributing to financial inclusion as these provide under-served and unbanked people with access to a broad range of formal financial services."[99]

Most discussions of mobile money in the context of financial inclusion are purely descriptive and we identified only one case – **Ghana (2018)** – in which assessors urged the authorities to promote mobile money specifically to expand financial access. Most recommendations concerning mobile money focused on AML/CFT regulations or risk controls.

In the context of financial inclusion:

- In **Bangladesh (2016)**, the assessors highlighted the role that bank-led mobile financial services were playing in enhancing financial inclusion.[100]

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[96] APG (Asia/Pacific Group on Money Laundering) *Anti-Money Laundering and Counter-Terrorist Financing Measures – Myanmar, Third Round Mutual Evaluation Report*. APG: Sydney, p. 27-28 and 86-86. 2018.

[97] ESAAMLG (Eastern and Southern Africa Anti-Money Laundering Group). *Anti-Money Laundering and Combating the Financing of Terrorism – Uganda, Second Round Mutual Evaluation Report*. ESAAMLG: Dar es Salaam, pp. 10, 13, and 19. 2016.

[98] ESAAMLG (Eastern ESAAMLG (Eastern and Southern Africa Anti-Money Laundering Group). *Anti-Money Laundering and Combating the Financing of Terrorism – Zimbabwe, Second Round Mutual Evaluation Report*. ESAAMLG: Dar es Salaam, p. 77. 2016.

[99] FATF. *Guidance for a Risk-based Approach: Prepaid Cards, Mobile Payments and Internet-based Payment Services*." FATF: Paris, p. 3. 2013.
And
FATF. 2013-2017. "*FATF Guidance: Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion – With a Supplement on Customer Due Diligence*." FATF: Paris, p. 74.

[100] APG (Asia/Pacific Group on Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures – Bangladesh, Third Round Mutual Evaluation Report*. APG: Sydney, p. 21. 2016.

- Mobile money is also recognized as important to financial inclusion efforts in the reports of **Armenia (2015),[101] Costa Rica (2015),[102] Madagascar (2018),[103] Vanuatu (2015),[104] and Zimbabwe(2017)**.[105]
- In **Myanmar (2018)**, the assessors note the low level of mobile money utilization, despite low levels of financial inclusion and high levels of mobile phone penetration.[106]
- In **Mauritius (2018)**, the assessors noted that mobile money was not especially well utilized, but that this was likely due to the otherwise high level of access to banking services.[107]

In the context of AML/CFT risk management, regulation, and supervision:

- In **Cambodia (2017)**, the assessors faulted the authorities for paying "insufficient regulatory attention . . . [to] remittance operators, in particular mobile payment service providers."[108] They advised the authorities to improve their understanding of the risks associated with mobile money.[109]
- In **Ghana (2017)**, the assessors acknowledged the role that mobile money had played in furthering financial inclusion, and recommend that the authorities "accelerate the promotion of financial inclusion by among other things . . . enhancing initiatives in the field of mobile money services."[110] At the same time, however, the assessors faulted

[101] MONEYVAL (Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Armenia, Fifth Round Mutual Evaluation Report*. MONEYVAL: Strasbourg, p. 75. 2015.

[102] GAFILAT (Financial Action Task Force of Latin America). *Anti-Money Laundering and Counter-terrorist Financing Measures – Republic of Costa Rica, Fourth Round Mutual Evaluation Report*. GAFILAT: Buenos Aires, p. 25. 2015.

[103] Here, though, the report also discussed ML/TF vulnerabilities emerging from the spread of mobile money. See: ESAAMLG (Eastern and Southern Africa Anti-Money Laundering Group). *Anti-Money Laundering and Combating the Financing of Terrorism – Madagascar, Mutual Evaluation Report*. ESAAMLG: Dar es Salaam, pp. 15-16. 2018.

[104] APG (Asia/Pacific Group on Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures – Vanuatu, Third Round Mutual Evaluation Report*. APG: Sydney, p. 30. 2015.

[105] ESAAMLG (Eastern and Southern Africa Anti-Money Laundering Group). *Anti-Money Laundering and Combating the Financing of Terrorism – Zimbabwe, Second Round Mutual Evaluation Report*. ESAAMLG: Dar es Salaam, p. 27. 2016.

[106] APG (Asia/Pacific Group on Money Laundering) *Anti-Money Laundering and Counter-Terrorist Financing Measures – Myanmar, Third Round Mutual Evaluation Report*. APG: Sydney, p. 27. 2018.

[107] ESAAMLG (Eastern and Southern Africa Anti-Money Laundering Group). *Anti-Money Laundering and Combating the Financing of Terrorism – Mauritius, Mutual Evaluation Report*. ESAAMLG: Dar es Salaam, pp. 26 and 32. 2018.

[108] APG (Asia/Pacific Group on Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures – Cambodia, Third Round Mutual Evaluation Report*. APG: Sydney, p. 67. 2017.

[109] APG (Asia/Pacific Group on Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures – Cambodia, Third Round Mutual Evaluation Report*. APG: Sydney, p. 81. 2017.

[110] GIABA (Inter-Governmental Action Group against Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Ghana, Second Round Mutual Evaluation Report*. GIABA: Dakar, pp. 62-63.

domestic financial institutions for not fully understanding the risks associated with such products, and for applying simplified due diligence to mobile money accounts without having first assessed the risk.[111] The assessors recommended that the authorities provide guidance on the risk-based application of SDD to mobile money and ensure that banks followed such an approach.[112]

- Similarly, **Bhutan (2016)** faulted banks for failing to conduct risk assessments prior to the introduction of mobile money services.[113]
- By contrast, **Indonesia (2018)** found that MSBs' embrace of new technologies such as mobile banking was "generally sound," with appropriate risk mitigation measures in place and pre-approval required by the country's central bank, Bank Indonesia.[114] The Central Bank of Samoa likewise had procedures in place to evaluate and approve new products and delivery channels, including for mobile money.[115]
- In **Uganda (2016)**, the assessors reported that the country lacked a "comprehensive legal and regulatory framework for mobile money" and that mobile money providers did not fully understand their ML/TF risks, nor did they have effective controls in place to counter them. They took issue with the balance and transaction limits, which they deemed "excessively high and . . . [a] significant ML/TF risk." They were also critical of the Bank of Uganda for "not ensuring that there is level playing ground with respect to AML/CFT compliance within the financial sector, with the mobile money service providers sector mostly affected." Elsewhere, the assessors called the country's lack of AML/CFT framework for mobile money "a missed financial inclusion opportunity."[116]

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[111] GIABA (Inter-Governmental Action Group against Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Ghana, Second Round Mutual Evaluation Report*. GIABA: Dakar, p. ix, 4 11, 61, and 68-69.

[112] GIABA (Inter-Governmental Action Group against Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Ghana, Second Round Mutual Evaluation Report*. GIABA: Dakar, pp. 62-63.

[113] APG (Asia/Pacific Group on Money Laundering).*Anti-Money Laundering and Counter-Terrorist Financing Measures – Bhutan, Mutual Evaluation Report*. APG: Sydney, p. 55. 2016.

[114] APG (Asia/Pacific Group on Money Laundering) *Anti-Money Laundering and Counter-Terrorist Financing Measures – Indonesia, Third Round Mutual Evaluation Report*. APG: Sydney, p. 79. 2018.

[115] APG (Asia/Pacific Group on Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures – Samoa, Third Round Mutual Evaluation Report*. APG: Sydney, p. 80. 2015.

[116] ESAAMLG (Eastern and Southern Africa Anti-Money Laundering Group). *Anti-Money Laundering and Combating the Financing of Terrorism – Uganda, Second Round Mutual Evaluation Report*. ESAAMLG: Dar es Salaam, p. 18, 35, 49, 53. 2016.

Appendices

Appendix 1. Expert Interviews

- Tom Abbell, Senior Manager, Accenture Development Partnerships
- Simone di Castri, Director, Policy and Ecosystem Development, Bankable Frontier Associates (BFA)
- Barry Cooper, Technical Director, The Centre for Financial Regulation and Inclusion (Cenfri)
- Emile van der Does de Willebois, Lead Financial Sector Specialist, World Bank
- Antonia Esser, Research Associate, The Centre for Financial Regulation and Inclusion (Cenfri)
- Xavier Faz, Senior Financial Sector Specialist, Customer & Provider Solutions, Consultative Group to Assist the Poor (CGAP)
- Louis de Koker, Professor of Law, La Trobe University
- Kennedy Komba, Head of Strategy, Member Relations, and Governance, Alliance for Financial Inclusion
- Tim Lyman, Lead Financial Sector Specialist, Consultative Group to Assist the Poor (CGAP)
- Louise Malady, Senior Research Fellow, UNSW Law
- Loretta Michaels, Independent Consultant
- Juliet Munro, Director of Financial Systems, FSD Africa
- John Muvavarirwa, Senior Financial Sector Expert, Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG)
- Leon Perlman, Head, Digital Financial Services Observatory, Colombia University
- Sebastian Rodriguez, Strategy Manager, Accenture
- John Symington, CEO, Compliance & Risk Resources
- Anne Wallwork, Sr. Counselor for Strategic Policy, Innovation, and Financial Inclusion, U.S. Department of the Treasury

Appendix 2. NPOs

- Among developing-country jurisdictions assessed by APG:
  - In **Bangladesh (2016)**, the assessors noted in their key findings for Chapter 4 that "AML/CFT controls on all NPOs go well beyond the FATF obligations and may disrupt legitimate NPO activities while still not addressing the risks." The assessors recommended that the authorities "refocus AML/CFT controls [on this sector] to avoid disrupting the legitimate activities of NPOs and better target TF risk mitigation."[117]
  - In **Cambodia (2017)**, the assessors noted that they had received feedback that the country's new Law on Associations and NGOs "impose onerous requirements on reporting financial information." They further noted that "there also appears to be some opposition to the law based on the impression that the law, which goes beyond the FATF requirements in its scope, places restrictions on gathering and assembly. This response to the law may affect compliance and therefore effective implementation."[118] However, we were unable to locate any recommendations that appeared to address this issue.
  - In **Indonesia (2018)**, the assessors found that while the country's 2017 NPO Regulation "is intended to apply only to those NPOs that were identified as being at high risk for TF, in practice it appears it will apply to a majority of NPOs." Though NPOs interviewed by the assessment team indicated they did not find the new requirements burdensome, the team nonetheless recommended that the authorities should "work to further refine the subset of NPOs that are identified at high-risk of TF abuse and subject to the NPO Regulation as well as enhanced monitoring."[119]
- Among the developing-country jurisdictions assessed by ESAMMLG:
  - In **Botswana (2017)**, the assessors found that the authorities' lack of understanding of the TF risks in the NPO sector prevented them from providing targeted assistance "without interfering with [the NPOs'] day to day legitimate dealings." The assessors recommended that "the authorities should also take measures to assist the NPOs which are likely to face a high risk of being abused for TF purposes without necessarily interfering with

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[117] APG (Asia/Pacific Group on Money Laundering) *Anti-Money Laundering and Counter-Terrorist Financing Measures – Bangladesh, Third Round Mutual Evaluation Report*. APG: Sydney, p. 62. 2016.

[118] APG (Asia/Pacific Group on Money Laundering). *Anti-Money Laundering and Counter-Terrorist Financing Measures – Cambodia, Third Round Mutual Evaluation Report*." APG: Sydney, p. 63. 2017.

[119] APG (Asia/Pacific Group on Money Laundering) *Anti-Money Laundering and Counter-Terrorist Financing Measures – Indonesia, Third Round Mutual Evaluation Report*. APG: Sydney, pp. 59 and 67. 2018.

their legitimate activities and make the NPOs aware of the possible risk of them being abused for TF."[120]

- Similarly, in **Mauritius (2018)**, the assessors recommended that the authorities "should take measures to assist the NPOs which may be at high risk of being abused for TF purposes without necessarily interfering with their legitimate activities."[121]

- In **Ethiopia (2015)** (published before the revision of R8 and the accompanying update to the evaluation methodology), the assessors reported that "international organizations and counterparts have noted that the laws governing the licensing, registration and supervision of charities and societies is having the impact of severely restricting NGO activities and thus disrupting and discouraging legitimate charitable activities." They pointed out that "while the licensing and regulation of NPOs is the prerogative of the government, such a broad level of oversight is not required from an AML/CFT perspective. The current blanket approach is in any event not justified by assessed TF risks." They relayed the authorities' justification for the law in question, which was, in part, that it "prohibits these NGOs from interfering in the internal political affairs of the country." The assessment team recommended that the authorities conduct a risk assessment of the NPO sector, which "will help to inform amendments to relevant laws and regulations, improve the outreach and guidance to the sector, and target the vulnerable NPOs for risk-based supervision and monitoring." They emphasized: "Under a risk-based approach, the less vulnerable NPOs receive lesser supervision.[122]

- In **Uganda (2016)**, the assessors noted that "although not required by the FATF Recommendations, [NPOs] are listed as reporting entities in terms of AMLA." In a footnote, the assessors were explicit that "the FATF does not recommend that all NPOs are brought under the AML/CFT framework. Recommendation 8 requires that authorities carry out a review of which NPOs are at risk for TF (not ML) and apply a limited set of measures to protect the sector from abuse by terrorist financiers. It is important that regulations and actions in this area do not harm the legitimate activities of such organizations." It recommended that "the country should no longer designate NPOs as DNFBPs (which is not a FATF requirement) and use

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[120] ESAAMLG (Eastern and Southern Africa Anti-Money Laundering Group). *Anti-Money Laundering and Combating the Financing of Terrorism – Botswana, Second Round Mutual Evaluation Report*." ESAAMLG: Dar es Salaam, p. 75. 2017.

[121] ESAAMLG (Eastern and Southern Africa Anti-Money Laundering Group). *Anti-Money Laundering and Combating the Financing of Terrorism – Mauritius, Mutual Evaluation Report*. ESAAMLG: Dar es Salaam, p. 75. 2018.

[122] World Bank Group and ESAAMLG (Eastern and Southern Africa Anti-Money Laundering Group). *Anti-Money Laundering and Combating the Financing of Terrorism: The Federal Democratic Republic of Ethiopia, Mutual Evaluation Report*. ESAAMLG: Dar es Salaam, pp. 18-19, 45-46, and 48. 2015.

some of the resources that become available to undertake a review of the TF risk in the NPO sector."[123]

- In **Zimbabwe (2016)**, among the priority actions for the country, assessors recommended "determine the TF risks associated with the NPO sector, and identify the NPOs which could be exposed or vulnerable to the TF risks and take appropriate mitigating measures without unnecessarily disrupting the legitimate business of the NPOs."[124]

- Among developing-country jurisdictions assessed by GAFILAT:
  - In **Mexico (2018)**, the assessors found that "current regulations governing the [NPO] sector are far more extensive and therefore more burdensome than what is required by the FATF, and not consistent with the risk-based approach as defined in revisions to R.8."[125] They recommended that the authorities "implement a more targeted approach to outreach to and monitoring of the NPO sector, based on the findings of the revised risk assessment."[126]
  - In **Nicaragua (2017)**, the assessors concluded that "targeted and proportionate measures have not been implemented for NPOs . . . which shows the lack of a risk-based approach to the sector."[127] They recommended that authorities "adequately assess the sector of NPOs in order to implement a risk-based approach."[128]

- Among developing-country jurisdictions assessed by MONEYVAL:
  - In **Albania (2018)**, the assessors found that "Albania applies enhanced measures to all NPOs using 'one size fits all' approach, which . . . does not ensure focus on the ones posing TF risks. Such approach fails also to ensure effective distribution of resources and may disrupt the activities of the legitimate NPOs and have a discouraging effect for the legitimate ones." This failure to distinguish high-risk from lower-risk NPOs contributed to

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[123] ESAAMLG (Eastern and Southern Africa Anti-Money Laundering Group). *Anti-Money Laundering and Combating the Financing of Terrorism – Uganda, Second Round Mutual Evaluation Report*. ESAAMLG: Dar es Salaam, pp. 27 and 45. 2016.

[124] ESAAMLG (Eastern and Southern Africa Anti-Money Laundering Group). *Anti-Money Laundering and Combating the Financing of Terrorism – Zimbabwe, Second Round Mutual Evaluation Report*. ESAAMLG: Dar es Salaam., p. 18. 2016.

[125] FATF and GAFILAT (Financial Action Task Force of Latin America). *Anti-Money Laundering and Counter-terrorist Financing Measures – Mexico, Fourth Round Mutual Evaluation Report*. FATF: Paris, pp. 82-83. 2018.

[126] FATF and GAFILAT (Financial Action Task Force of Latin America). *Anti-Money Laundering and Counter-terrorist Financing Measures – Mexico, Fourth Round Mutual Evaluation Report*. FATF: Paris, p. 78. 2018.

[127] GAFILAT (Financial Action Task Force of Latin America). *Anti-Money Laundering and Counter-terrorist Financing Measures – Republic of Nicaragua, Fourth Round Mutual Evaluation Report*. GAFILAT: Buenos Aires, p. 76. 2017.

[128] GAFILAT (Financial Action Task Force of Latin America). *Anti-Money Laundering and Counter-terrorist Financing Measures – Republic of Nicaragua, Fourth Round Mutual Evaluation Report*." GAFILAT: Buenos Aires, p. 71. 2017.

Albania only received a "moderate" effectiveness rating for IO 10. The report made several recommendations to address these deficiencies.[129]

- In **Armenia (2015**), the assessors concluded that in the absence of a formal risk assessment of the NPO sector, "it is doubtful whether the authorities are in a position to undertake a targeted approach without disrupting legitimate NPO activities." The assessors further noted that "a number of requirements apply indiscriminately to all NPOs." These findings contributed to a "not met" designation in the Technical Compliance Annex for Criterion 8.1(b).[130]
- In **Ukraine (2017)**, the assessors reported that "the private sector appears to treat all NPO customers as high risk for FT," noting that in onsite visits, "all private sector institutions indicated that they applied EDD to NPO clients, or chose not to service them altogether." Yet these institutions were unable to articulate how they would identify a high-risk NPO. These findings contributed to Ukraine receiving only a "moderate" effectiveness rating for IO 10. The assessment team recommended that the authorities conduct further outreach and improve their implementation of the risk based approach "in order to ensure that the NPO sector is protected from terrorist abuse without disrupting or discouraging legitimate charitable activities."[131]

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[129] MONEYVAL (Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Albania, Fifth Round Mutual Evaluation Report*. MONEYVAL: Strasbourg, pp. 81, 91, and 93. 2018.

[130] MONEYVAL (Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Armenia, Fifth Round Mutual Evaluation Report*. MONEYVAL: Strasbourg, pp. 69 and 123. 2015.

[131] MONEYVAL (Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism). *Anti-Money Laundering and Counter-Terrorist Financing Measures: Ukraine, Fifth Round Mutual Evaluation Report*. MONEYVAL: Strasbourg, pp. 83, 91, and 92. 2017.