AML/CFT implementation in developing countries and financial inclusion

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South African experience triggered:

- Financial sector charter and FICA implementation

Objective:

- How to facilitate FATF implementation in developing countries without undue impact on access to financial services

Steering Committee:

- World Bank, IMF, DFID, CGAP, South African National Treasury, FinMark Trust

Background

- **Products:**
  - Transaction banking
  - Remittances
- **Impact of AML/CFT vs other factors**
- **Formal and informal financial services**
- **Countries:**
  - Indonesia
  - Kenya
  - Mexico
  - Pakistan
  - South Africa

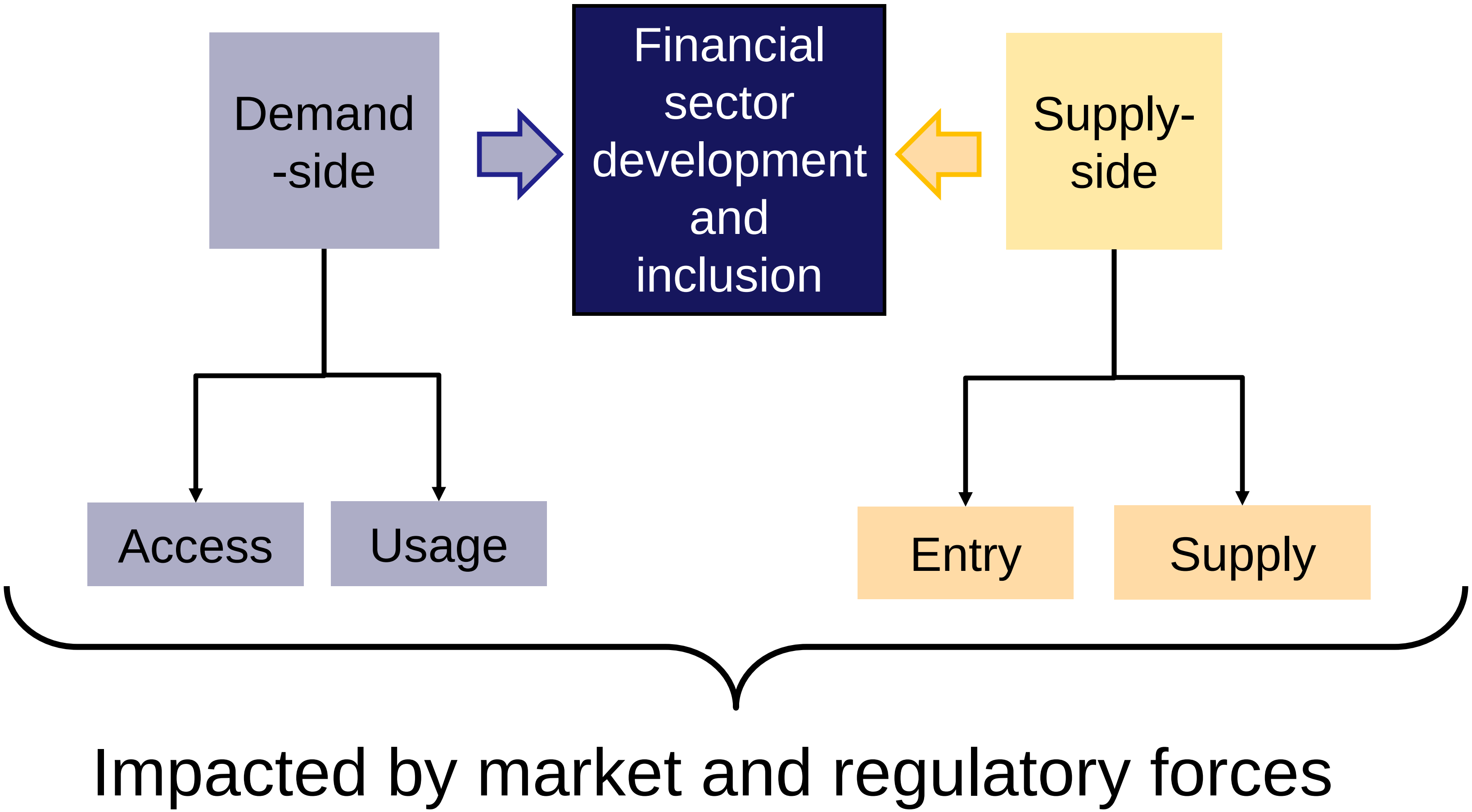
Focus

1. Effective AML/CFT enforcement and financial inclusion are complementary and not contradictory policy objectives

2. AML/CFT do impact financial inclusion

3. Countries are finding ways to deal with the it

Key findings



Financial inclusion framework

	South Africa	Kenya	Pakistan	Indonesia	Mexico
Regulation	• AML law since 2002 • CFT law passed in 2004	• AML bill published • Prudential regulations under Banking Act	• AML bill • Prudential regulations under Banking Ordinance	• AML law operative since 2002	• AML regulations since 1997
Bank account Usage	46%	18%	6-10%	29%	25% (Mexico City)
Bank account: Access	67%	20%	15%	45%	50-64%

Country context

Countries go through various phases in implementing a local AML/CFT system:

Phase 1

- Developed country templates promulgated
- No significant domestic policy-making process

Phase 2:

- Selective government enforcement
- Determined by capacity, foreign exposure or presence of a champion
- Fin Inst's unable to comply

Phase 3

- Regulation gradually adjusted to domestic realities and capacity
- Impact on access mitigated

These phases repeat themselves in sub-sectors as international standards are adjusted/ new ones introduced

Implementation evolution

1. Limitations in national ID infrastructure
2. Limited supporting public infrastructure

   - capacity of financial supervisor
   - law enforcement
   - capacity to formalise

3. Formal financial institutions – structure, capacity and incentives
4. Large-scale informal financial services
5. Linkages to international financial markets

Drivers of impact

- Inability to provide verification documents
- Re-identification processes
- Door-step barriers
- Financial institutions sever relationships with unsupervised institutions
- Increased transaction costs cause withdrawal from low-income markets
- Can delay new technologies

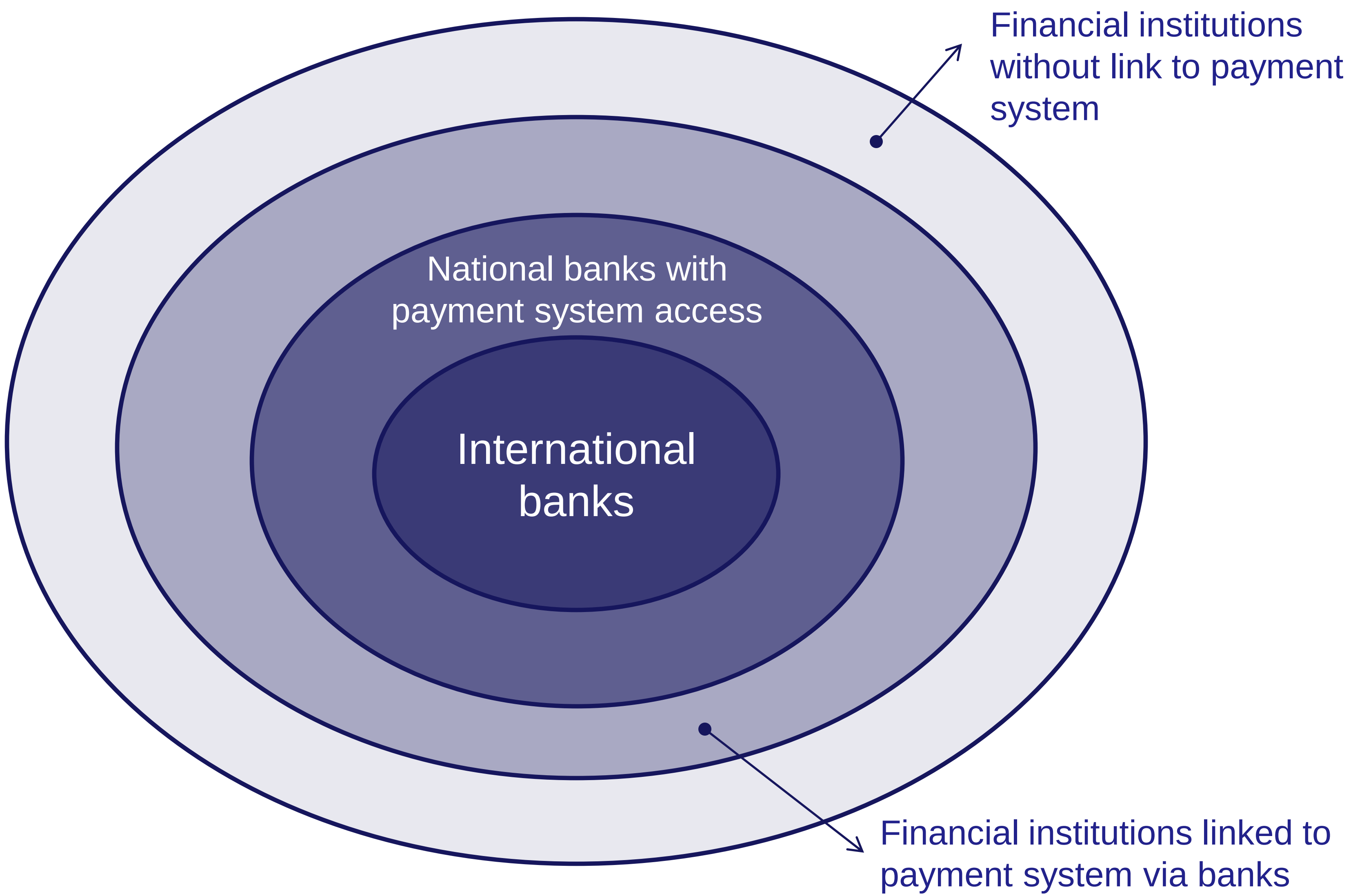
Impact

Adjustments applied by regulators:

1. Re-calibrate existing controls on a risk-sensitive basis

2. Sequence implementation of controls across sectors, transactions or financial entities

Regulator responses



AML risk in financial institutions

AML/CFT risk & mitigation measures

ML risk	Mitigation
1. High value transactions	Cap transaction value
2. Cross border	Domestic transfers only
3. Payment System-linked institutions	1. Focus on high risk 2. Place onus on regulated institutions 3. Sequence application of controls

FT risk	Mitigation
Clients linked to terrorism	Check against lists of known terrorist organisations and persons

Mitigating responses: Sequencing

Coverage

- Regulatory framework exists
- Financial institutions visible to the regulator

Traceability

- Basic institutional regulation in place
- Basic identification of clients
- Transaction records accessible

Profiling and monitoring

- Clients identified and profiled
- Transactions monitored for AML/CFT purposes (often manually)

Verification and interdiction

- High levels of verification with integrity possible
- Financial institutions can interdict transactions

State Bank of Pakistan

- 1 m formal vs 4.6m informal (households) remittances

Getting the market to assist with AML implementation:

1. $6.50 subsidy to reduce transfer costs
2. Formalise and consolidate money changers to increase competition (created Category A and B money changers)
3. Reduce differential between official exchange rate and kerb rate
4. Support Pakistanis abroad
5. Improve efficiency of formal channels

Money transfer services in Pakistan

Guidelines

Nine guidelines developed to assist with development of AML/CFT regimes that complement financial inclusion

Report and guidelines available on CD

Thank you!

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