Reply to Public Consultation

FATF Review of the Standards - Preparation for the 4th Round of Mutual Evaluations

AFI welcomes the opportunity to comment on FATF's review of its 40+9 Recommendations and to predominantly contribute to the financial inclusion perspective and agenda. AFI is a global network of policymakers, in developing countries, which provides members with tools & resources to develop, share & implement their knowledge of cutting-edge financial inclusion policies. AFI's goal is to support the exchange of knowledge between developing countries on successful financial inclusion policies. Members are represented by senior officials of Ministries of Finance, Central Banks and leading financial regulatory institutions in more than 60 countries.

The **AFI Financial Integrity Working Group (FINTWG)** is a group of seven countries (South Africa, Malawi, Kenya, Indonesia, Philippines, Mexico and Peru) with special interest in exchanging views and experiences on identifying and leveraging the complementarities between financial integrity and financial inclusion. This document represents their consolidated view.

Based on FATF's current review of the Risk Based Approach (RBA), Customer Due Diligence (CDD), reliance on third parties and tax crime as a predicate offence for money laundering, members provided their views on, (a) The Risk-Based Approach and related Recommendations; (b) Recommendation 5 (Customer Due Diligence); (c) Recommendation 8 (New technologies and non-face-to-face business), and (d) Recommendation 9 (Third-party reliance) as they are the most relevant to the financial inclusion agenda.

AFI members understand that the primary objective of the FATF is to develop and promote national and international policies to combat money laundering and terrorist financing and recognize its importance in the

financial stability framework of their individual countries. Concomitantly, financial inclusion complements and strengthens the effectiveness of this mandate, in particular the enforcement of AML/CFT policies while equally contributing to the effectiveness of financial stability in the long run. That said, finding the right balance between these objectives will be crucial to the effectiveness of implementing such policies. Developing countries have already experimented with these policies and have developed innovative solutions, and offer experiences that could add value to the FATF processes. The following is the collective contributions from our members to this process, for FATF to consider.

Risk Based Approach

A common view emerged within the group is that there is room and scope for greater clarity on the RBA parameters and associated obligations.

Members suggested that a single comprehensive statement about the application of RBA in relation to CDD could be preferable over the dispersed references in the current 40+9 Recommendations document. An added benefit would be that a consolidated statement could explicitly confirm that RBA is an acceptable method for CDD implementation. To add further clarity, there is support for the proposed draft of Interpretative Notes.

The Members support the initiative to include examples of high and low risk ML/TF financial products and expressed their interest on benefiting from a wide variety of examples. Further, a clearer distinction between "risk factors" and "risk characteristics" would be welcomed as well as clarification of the differences in obligations of financial institutions and DNFBPs.

Regarding the feasibility of meeting the new RBA elements proposed by FATF, concerns were raised on the challenge of translating the elements of the RBA into effective policies (legislative provisions) for the countries. For example, some jurisdictions face significant challenges in the implementation of the new RBA elements due to an absence of or insufficient infrastructure regarding civil registration or identification systems.

A clear understanding of the principles and obligations associated with the RBA is a crucial precondition for implementation (discussed further below). The additional clarification in the Interpretative Notes will make this easier if the previously expressed clarifications are considered.

Countries' legal and regulatory frameworks may vary in their flexibility to adopt the RBA. The same holds true at the level of financial institutions, where DNFBPs and smaller financial institutions will be challenged in establishing risk measures and mitigation procedures. The challenge will include creating infrastructure that will provide meaningful information to conduct an effective risk assessment and creating a proper framework for supervision (discussed below).

An important clarification required from members on the analysis of risks is what will be considered a reasonable appropriate implementation time and/or an implementation period for the establishment of the new RBA elements proposed by FATF. It is commonly understood that a risk assessment should be done at the beginning of the business relationship, and ongoing monitoring should take place to obtain a clear understanding of customer behavior. However, it is still unclear what the elements of on-going monitoring means in practicality and how this is demonstrated to FATF in the context of assessment. Guidance will therefore assist authorities, who will spend time and resources to provide suitable direction for financial institutions.

There is significant support for FATF to give guidance on how risk assessments should be conducted, e.g. by providing examples of crucial elements in such assessments that are acceptable to FATF. Countries feel strongly that a risk assessment performed by authorities should be accepted based on the common understanding of the guidance provided by FATF on what the crucial elements of a risk assessment are. FATF's guidance could ensure a common understanding while maintaining the flexibility to be tailored to countries' different risks. However, the different realities of different jurisdictions need to be considered and guidance should be tailored to take this into account. The FINTWG considers including specific examples of how risk assessment ought to be done as helpful in crafting the necessary regulations or programs aligned with the RBA.

In particular, FATF should consider giving examples on how risk assessments should be undertaken by financial institutions faced with customers or transactions posing ML/TF risks varying from high to low, as well as those meriting exemption(s) from being subject to stringent anti-ML/TF regulations. FATF could likewise provide guidance and clarify risk assessment measures at the Supervisory Authorities level, as well as possibly

provide examples of how other jurisdictions regulate such financial institutions catering to various clients posing varying degrees of ML/TF risks.

Ideally, risk assessment should precede the implementation of RBA at the national level for those that have not introduced the RBA yet. This positions authorities to provide better guidance to institutions, which have to assess and manage risks pertinent to their business. Meaningful and accurate information is crucial to the risk-based framework of any country. Further, it would be helpful if FATF provided some guidance as to how the two processes (national assessment and assessment by financial institutions) are linked and how they feed into each other. Financial institutions ought to conduct risk assessment before and during roll-out of new products. In both phases, controls should be implemented in relation to the assessment results. It is clear that the initial controls would be less accurate and be based on past experiences or similar products.

Recommendation 5 (Customer Due Diligence or CDD)

There are concerns regarding the correct application of FATF standards, primarily relating to implementation of customer identification measures, reliability of documents, legal aspects of personal data use and information on ongoing CDD.

For example, many countries do not have a sufficient, if any, infrastructure relating to registration or identification systems and thus the implementation of customer identification might be virtually impossible in countries without an ID system. A challenge is also posed by the reliability of identification documents and usage of various documents in systems, where there is no single standardized national identification document, an example of which is refugees and migrants who have no documentation at all. An appropriate approach to the development of financial inclusion will be to consider what alternative forms of confirmation of a customer's identity would be considered sufficiently 'independent' and 'reliable' to be an acceptable means of confirming a person's identity in the absence of a registration or identification system, and to draw from countries that have considered such alternative forms of identification. This could be in the form of a guidance paper.

For example, in some countries it is not common to use street addresses in rural or peri-urban areas. And in one instance, financial institutions in rural areas rely on letters from village chiefs as ID documents. The question then

that arises is how acceptable is this in the context of the FATF assessment and the RBA?

It would be helpful if FATF could establish what other, alternative means and sources of identification for both natural and legal persons ought to be considered as valid. Another helpful measure would be to clarify what are reliable sources for verification of foreign clients. Finally, jurisdictions would benefit from obtaining more precise clarification of what measures constitutes ongoing CDD.

There is also a need to obtain more information on the risks associated with products targeted at the poor population. It is important to recognize that products targeted at the poor are not automatically low risk, just because of the target group and low value accounts. Some products contribute to financial inclusion, but might be a high ML/TF risk - in this case FATF and regulators must give more thought to appropriate regulatory framework to strike a balance between access and risk. Further, jurisdictions would find it helpful to obtain more information about the risk variables in assessing ML/TF risks that increase or decrease the potential risk and result in changes to the extent of CDD measures.

Relating to products targeted at the poor, there could be specific challenges related with the application of CDD measures. For example, there is the challenge of coming up with parameters to classify products as ‘low risk’ or to set minimum acceptable CDD measures for low-risk products. Practical examples provided by FATF are helpful for better understanding.

As mentioned above, FATF may provide regulators and supervisors with more guidance on the supervision in this regard, in particular for low-risk products in the form of practical examples as well as training. It would be of great benefit to obtain more information about the range of risk factors relating to an institution’s systems and controls for assessing ML and TF risks. FATF could provide examples of how low-risk products and services are used in ML/TF transactions as well as information on methodologies in other jurisdictions to combat ML/TF associated with such transactions. This would assist the countries in combating ML/TF and in drafting proportional regulations. The FINTWG would propose to introduce more training workshops involving experience from other jurisdictions.

Recommendation No. 8 (New technologies and non-face-to-face business)

From our discussion, a view emerged that there is room for greater clarification for the new R.8 parameters. Specifically, our members found that the criteria \ leaves large discretion to jurisdictions about risk management with regard to the development of new products and allows varied interpretation of the criteria - if it can be justified. Practical examples of specific CDD measures would be helpful in the context of R.8. Further, the FINTWG suggests providing better description on the types of additional information required once customers of financial institutions are trying to access more advanced services. It is not clear at the moment, what FATF regards as sufficient mitigating measures (such as low-transaction account) and where it sees the main conflicts with risks of ML/TF. Clarification of these points would be greatly beneficial.

Members are positive about the feasibility of meeting the new elements on the RBA and R.8 as proposed by FATF.

New technologies are often considered as an innovative channel to expand access to finance. More guidance regarding fast-paced technological change is needed and members cautioned FATF to not assume that new technologies used for provision of financial services would be automatically high-risk, but treat them as any other product. With regard to FATF's future approach to new technologies, the FINTWG considers a comprehensive analysis, pointing to specific risks of which jurisdictions should be aware regarding new technologies, as valuable. Clearer guidance is needed on the risks and as to whether such solutions as low transaction accounts provide sufficient risk mitigation. Further, the FINTWG encourages FATF to hold regular dialogues with the financial services industry to enable proactive identification of risks regarding new technological developments.

Recommendation No. 9 (Third party reliance)

There is a general consensus that the new parameters included in R.9 are sufficiently clear, except that it would be beneficial to obtain definitions on 'outsourcing' or 'agency' relationships as well as 'reliance on third-party', potentially in the Glossary. The delineation between outsourcing and third-party reliance ought to be clarified. Practical examples on the aforementioned concepts would be of great value.

It is generally felt that most members find it feasible to meet the new elements of R.9, qualified by the fact that it is feasible for jurisdictions, which permit third-party reliance to meet the new parameters.

However, there are some concerns members wish to highlight: (1) Greater clarity on the appropriate treatment of relationships such as outsourcing or agency by the regulator is needed, (2) clarity on the appropriate contractual arrangements for outsourcing services that ought to be in place in financial institutions, (3) clear definitions of obligations and responsibilities between financial institution and agents. This particular concern, although raised under R.9, can be clarified under R.5.

One related thought expressed is that some institutions might not be subject to AML/CFT obligations, such as telecoms or pre-paid scheme providers or, in the same vein, e-money issuers or other entities that serve as banking agents in rural areas. For those, it would be necessary to establish who should carry the main supervision responsibility regarding these institutions. Concerns regarding data protection and the safeguarding of customer information were raised and the importance of data protection legislation and the protection of sensitive customer information, especially when third parties are used.

Members believe that countries that allow financial institutions to use agents should be able to demonstrate the adequacy of the safeguards in place. Currently, some of our members already have measures in place for third-party usage for CDD.

Another important concern relates to the ability to apply the new elements of the RBA across-the-board as some new products might be outside of the regulatory realm of the supervisor or some components of the value chain may not be supervised. One example is m-banking: Provision of mobile financial services depend on several participants in the payment chain, some of which might be subject to compliance with R.8, whereas others are not (e.g. transaction processing companies). Associated with these vertical production chains in payment service provision are problems relating to legal responsibilities, for example reporting of STRs.

There is unanimous support for the concept of Know-Your-Agent (KYA), in other words CDD on agents being conducted by financial institutions. The use of agents is a valuable means to increase outreach of financial services to underserved segments of the population. While some members are of the opinion that this approach can be accommodated within the FATF

framework, it is believed that FATF could place more emphasis on this type of arrangement in the context of financial inclusion. Several members would like FATF to provide more guidance on KYA approaches.

In countries that already require their supervised institutions to submit information on third parties to their local financial authorities, KYA would not provide much additional value, but there are still areas that require clarity. For example, there is the question concerning STR-requirements: do they need to be fulfilled by financial institutions or agents? FATF could probably provide practical examples on practices of KYA related to CDD requirements. There is a clear consensus among FINTWG countries that financial institutions are responsible for their agents.

We would like to express our appreciation of the opportunity for public consultation with FATF and hope to contribute to FATF procedures with our input as AFI FINTWG.

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