

ML/FT risk and financial inclusion of the poor: increase the focus on actual usage of formal financial services

In the past 10 years, FATF has done much to improve its understanding of the complex interplay between financial integrity objectives and financial inclusion. This work, however, has not extended to analyze and assess the integrity risks related to financial exclusion. This leaves FATF's risk-based approach to ML/FT unbalanced, focused mainly on criminal risks to the formal financial system and somewhat blind to the integrity risks of exclusion that ill-considered though FATF-compliant AML/CFT strategies may hold.

Financial exclusion, the shadow economy and tax evasion were not integrated into the FATF strategy until rather late. In the mid-2000s, FATF stakeholders still refused to acknowledge that AML/CFT compliance with FATF's standards could hamper the implementation of policies to increase access by the poor to the financial system. It required intensive effort and lobbying by a group of South African development economists and AML/CFT experts to secure funding for a five-country study on the impact of AML/CFT measures on financial inclusion. The study was deemed too sensitive for funding by major FATF stakeholders, who were concerned that financial inclusion would undermine AML/CFT measures. With FIRST Initiative funding and the personal support by a number of experts, the study was eventually launched. When its findings were circulated in 2007 and finally published in 2008, evidence was available that changed FATF's approach (Bester *et al.*, 2008; Isern and De Koker, 2009). This study found that "(t)he pursuit of financial inclusion and the pursuit of an effective AML/CFT regime are complementary and not conflicting financial sector policy objectives". In 2009, the president of FATF embraced the findings and language of the report when he held in Lesotho addressing the ESAAMLG Ministers that "Financial inclusion and an effective financial integrity regime can – and should – be complementary national policy objectives" (Vlaanderen, 2009).

FATF has since adopted a 2011 guidance paper on financial inclusion, which was revised in 2013 and enhanced by a supplement on simplified due diligence in 2017. The current mutual evaluation methodology also enables assessors of the effectiveness of a country's AML/CFT system to consider aspects of its financial inclusion policies, where they deem that relevant.

The reasons why FATF embraced financial inclusion are alluded in a few documents and speeches. In essence, financial inclusion is viewed as a means to limit untraceable, informal cash transactions that compromise the ability of countries to track money laundering and terrorist financing. As expressed by the then Princess Máxima of The Netherlands in a 2010 address to FATF:

[Financial inclusion] helps regulators and supervisors monitor and trace the movement and sources of money. It helps law enforcement by diminishing the anonymity of informal transactions. In short, financial inclusion contributes to financial integrity (Princess, 2010).

These objectives are important to FATF. It has been actively providing guidance and countering large-scale de-risking account closures to ensure that the implementation of its standards do not hamper the provision of financial services to the poor and marginalized. It is submitted, however, that a focus on the provision of services and account opening only will not achieve the integrity results that FATF desires.



It is easily assumed that a person who gains access to the formal financial system ceases to use informal services. That is of course not the case. Evidence has shown that holding a bank account may not lead to a withdrawal from informal financial services (De Koker and Jentzsch, 2013). First, access may not necessarily translate into active usage and, second, even active users may opt to use cash and informal services for certain transactions.

Examples of access without active usage abound. In the mid-2000s, South Africa saw an impressive number of basic bank accounts – Mzansi accounts – opened but the Mzansi project ultimately failed as the majority of accounts were not actively used. In 2016, nearly 30 per cent of India’s 200 million flagship Jan Dhan Yohana inclusion accounts had a zero balance and a significant number held only 1 rupee (Shettar, 2016). According to the Global Findex Database 2017, 20 per cent of account owners globally made no deposit into and no withdrawal from their account in the previous 12 months (Demirgüç-Kunt *et al.*, 2018). In 2017, the GSMA noted that of the more than 500 million mobile money accounts then opened globally, 170 million were in active use (GSMA, 2017). Having customers on the books has little impact on AML/CFT risk if they do not use those accounts to transact – and clearly millions of customers do not do so.

Those who were formerly excluded and who do use their new accounts actively may, just like long-time users of financial services, not necessarily use the accounts for all transactions. Consumers generally decide transaction by transaction how they wish to transact (De Koker and Jentzsch, 2013). Do they want to pay for a train ticket or settle a meal using cash, their payment card or a mobile payment method? A variety of factors, including cost and convenience, may influence that decision. In some cases, of course, the customer may not have a choice, for instance, where a shop refuses to accept a card payment or, increasingly in cash-lite Nordic countries, where they may refuse to accept cash.

A variety of usage barriers may be relevant to newly included customers. A lack of usefulness of new payment methods looms as an important obstacle in many developing countries. A customer receiving her salary in her new account may need to withdraw most of it on receipt if her purchases and payments can only be made in cash. Interoperability is also a barrier for mobile money payments in a number of countries: a mobile payment service is less useful if it is used only to pay people who use the same network provider. Costs are of course also an important barrier. If it is more expensive to use non-cash payment methods, customers tend to withdraw their funds to rather spend them in cash.

Surveillance, the very reason why FATF is so supportive of inclusion, may also be relevant. In countries where users are concerned about the surveillance of their transactions, some transactions may rather be concluded in cash. Even though it may be convenient to use a non-cash payment method, such a user may prefer to make a sensitive payment, for example, the payment of membership fees of an opposition party, in cash. This behavior is also evident in relation to the use of telecommunication services. Where people are concerned about surveillance of the telecommunications, they do not withdraw from these services. They use those services generally but opt to meet in person when discussions are sensitive. The same choices occur of course in developed economies where shadow economies are sustained by cash transactions between people who generally have access to the formal financial system.

Instead of focusing mainly on whether people are able to gain access to the financial system, it is important for FATF and AML/CFT regulators to also consider whether and how users use formal financial services once they have gained access and, importantly, why they may elect to use informal services and cash. Usage is vital from a financial transparency perspective. Where barriers unnecessarily prevent or discourage comprehensive usage, these should be identified and addressed. Costs, abusive surveillance,

privacy and data concerns should receive particular attention. Policies that increase the utility of non-cash payments and encourage such payments should be supported. This extends to the phasing out of large bank notes (De Koker, 2011). These issues are relevant from a number of policy perspectives but they should be recognized as key to a comprehensive AML/CFT strategy too. In addition, the linkages between the cash economy, financial exclusion, tax evasion, ML/FT and the usage decisions of users should be studied to identify strategies that would appropriately align financial inclusion and the post-2012 financial integrity objectives of FATF.

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