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Inclusion and diversity: Addressing financial exclusion in the age of enhanced compliance

**Academy of Excellence in Financial Crime
Investigation and Compliance**

De-Banking in the Asia-Pacific Region

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Glossary and Abbreviations

Term	Definition
Anti-money laundering	Efforts to prevent criminals from disguising illegally obtained funds as legitimate income
Combatting the financing of terrorism	Efforts to prevent terrorist groups from laundering money through the banking system or other financial networks
Customer due diligence	Compliance framework for preventing financial crime and uncovering any risks to banks and other financial institutions that could arise from doing business with certain customers
De-banking	The phenomenon of banks and other financial institutions terminating, declining or limiting financial services across a whole sector/s because holders/applicants are perceived to pose an unacceptable and/or unmanageable risk in terms of complying with anti-money laundering and countering the financing of terrorism regulations
De-risking	The practice of banks and other financial institutions terminating or declining to open accounts because holders are perceived to pose an unacceptable and/or unmanageable risk in terms of complying with anti-money laundering and countering the financing of terrorism laws
Financial inclusion products	A finance product offered by a bank or other financial institution designed to increase access to financial services for traditionally underserved or excluded populations
Know Your Customer	The aspect of customer due diligence that deals with the identity and verification of customers
Risk-Based Approach	Managing (as opposed to simply avoiding) risk by identifying, assessing, and understanding the risk, and taking the appropriate mitigation measures in proportion to the level of risk
Simplified Due Diligence (SDD)	The lowest level of customer due diligence that a bank or other financial institution can employ, entailing a brief identity verification process that can be applied to eligible finance products when the risk of money laundering or terrorism financing is deemed low

Abbreviation	Term/Entity
ADB	Asian Development Bank
AML	Anti-money laundering
APG	Asia-Pacific Group on Money Laundering
CDD	Customer Due Diligence
CFT	Combatting the Financing of Terrorism
FATF	Financial Action Task Force
FIU	Financial Intelligence Units
IFC	International Financial Corporation
IMF	International Monetary Fund
KYC	Know Your Customer
ML	Money Laundering
NPO	Nonprofit Organization
RBA	Risk-Based Approach
MSME	Micro-, small- and medium-sized Enterprise
RegTech	Regulatory Technology for Financial Institutions
SDD	Simplified Due Diligence
SupTech	Supervisory Technology for Regulators
TF	Terrorist Financing
UN	United Nations

Executive Summary

According to the World Bank Group, the Asia-Pacific region accounts for half of the world's unbanked.¹ This White Paper explores how policymakers, banks and other financial institutions in the Asia-Pacific region can manage the trade-off between financial inclusion and compliance with regulations on anti-money laundering/combating the financing of terrorism (hereinafter "AML/CFT"). This tradeoff may manifest itself in de-banking of existing or prospective customers. In addition to undermining financial inclusion efforts, de-banking frustrates AML/CFT objectives by pressuring higher-risk transactions out of the regulated system into murkier, informal channels that are more difficult to track.

What is de-banking?

Individuals and businesses are "de-banked" when a bank/financial institution closes their account, declines to open one or limits the types of financial services offered. Although persons can face difficulties accessing financial services for many reasons, de-banking is largely reported in situations where it is caused by AML/CFT-compliance related issues.

Opening an account with a financial institution is a key, yet potentially difficult, component of accessing financial services. One of the biggest challenges for (potential) customers of banks and other financial institutions is meeting AML/CFT requirements related to personal identification and verification. Such requirements typically entail the collection of mandatory documentation (to open an account) that certain applicants do not have and/or cannot easily obtain.

Which international organization(s) sets standards relevant to de-banking?

In the last two to three decades, countries around the world, including in the Asia-Pacific region, have established AML/CFT frameworks based on standards issued by the Financial Action Task Force (hereinafter "FATF"). FATF and FATF-style regional bodies like the Asia Pacific Group on Money Laundering (hereinafter "APG"), incentivize member-States to conform their frameworks to international standards by publishing "mutual evaluations" that assess the strength of the relevant jurisdiction's AML/CFT regime. However, with the proliferation of AML/CFT regulations, new concerns have arisen as to their effect on global efforts to eliminate poverty, including initiatives aimed at increasing access to finance for traditionally underserved and excluded populations.

What is de-banking's effect on global financial inclusion efforts?

International organizations, such as the United Nations (hereinafter "UN") and Asian Development Bank (hereinafter "ADB"), have made significant investments in partnership with national governments supporting the establishment of financial infrastructure across the Asia-Pacific region through legal and institutional reforms. Such infrastructure is necessary to make it possible for banks and other financial institutions to offer financial services to underserved and excluded populations. However, it has become widely recognized that the impact of these investments may be undermined by legal and reputation risks that drive financial institutions to adopt a rigid application of AML/CFT measures, causing broad categories of persons to become (or remain) de-banked. De-banking disproportionately affects underserved and excluded populations, including women, youth, migrants, refugees, farmers, indigenous communities, as well as micro-, small- and medium-sized enterprises.

What is currently being done to reduce de-banking?

FATF has made commendable efforts in recent years to studying the unintended consequences of AML/CFT regulations. As awareness about the de-banking problem has grown, FATF has issued revised standards that consider financial inclusion and support the operations of Non-Profit Organizations (hereinafter "NPOs"). FATF has also issued guidance to countries on how to implement

¹ See Global Findex Database (World Bank Group, 2015), <https://www.worldbank.org/content/dam/Worldbank/Research/GlobalFindex/PDF/N2Unbanked.pdf>. See also Financial Inclusion in Asia Country Surveys (ADB, 2014), <https://www.adb.org/sites/default/files/publication/159308/adi-financial-inclusion-asia.pdf>.

risk-based AML/CFT compliance frameworks. However, countries have been slow to amend their AML/CFT legal and compliance frameworks in light of this updated standards and questions remain about whether the national frameworks are fit and proper for high-risk sectors, including correspondent banking and remittances. Financial exclusion rates also remain high across the Asia-Pacific region.

What can be done further to address de-banking?

In order to reduce the potential risk of enforcement action, many banks and other financial institutions engage in the practice of de-risking. The lack of clear national level guidance from national Financial Intelligence Units (hereinafter "FIUs") exacerbates this issue. National guidance does not typically detail what systems and controls to apply for higher risk customers. In many cases, national authorities and FIUs issue guidance that is very general in character and has been criticized for being overly cautious in tone. As a result, it is challenging for banks and other financial institutions, at the enterprise level, to design compliance frameworks that facilitate (1) identification of low-risk "financial inclusion products" – and, on this basis – (2) application of simplified procedures for more cost-effective management of associated accounts. Developing such guidance would make it easier for banks and other financial institutions to offer financial inclusion products to more vulnerable customers, thereby increasing access to finance in line with financial inclusion objectives.

Furthermore, it is important to point out the limitations of standard-setting bodies like FATF in actually driving change within national finance sectors. For example, FATF Recommendation 10 on customer due diligence requires an understanding of risk and to complete identify verification procedures before the provision of a service. Such prescriptive requirements on timing and sequencing of initial KYC steps is an outdated approach and does not necessarily lead to effective assessments of customer risk. Instead, customer due diligence mechanisms should be outcomes focused and provide greater flexibility. To enhance the effectiveness of such guidance, regional bodies such as the ADB or World Bank can proactively work with local regulators to support relevant policy reforms. Only through such reforms will local banks and other financial institutions follow suit.

What are the proposed next steps?

This White Paper proposes future work on a guidance document about risk-based AML/CFT compliance frameworks for policymakers, banks and other financial institutions seeking to address de-banking. This document would provide guidance on how to implement the FATF standards and strategies, while providing concrete examples of the tools that may be deployed to alleviate de-banking/de-risking.

Introduction

The White Paper is divided into four Sections. Section I provides a brief overview of existing AML/CFT frameworks, with a focus on the work of FATF. Section II discusses potential solutions for banks and other financial institutions to address de-banking, such as applying the Risk-Based Approach and technological innovation. Section III examines how de-banking affects international efforts at increasing financial inclusion through the establishment of necessary financial infrastructure in line with National Financial Inclusion Strategies. Finally, Section IV summarizes the White Paper's key findings and recommendations, including a proposal to develop a guidance document to support policymakers, banks and other financial institutions with their efforts to address de-banking.

The White Paper examined data on ten Asia-Pacific jurisdictions as per the table below. The table also indicates whether the jurisdiction in question is a member of FATF and/or APG, its income level, as well as its score on the latest Anti-Money Laundering Index developed by the Basel Institute on Governance. The higher the score, the higher the risk of money laundering and terrorist financing.

Other jurisdiction-specific data, such as with respect to AML/CFT legislation, National Risk Assessments, and National Financial Inclusion Strategies, can be found in Tables 2-3, and Tables 6-7. In addition, this White Paper provides six case studies relevant to de-banking from the Pacific Islands, Sri Lanka, Australia, Hong Kong, Malaysia, Pakistan, and Philippines, which are contained in Boxes 2-8.

Table 1: Selected Asia-Pacific Jurisdictions

Jurisdiction	FATF	APG	Income level	AML Index
Cambodia	No	Yes	Lower-Middle	6.78
Indonesia	Yes	Yes	Lower-Middle	5.01
Japan	Yes	Yes	High	4.66
Malaysia	Yes	Yes	Upper-Middle	5.21
Pakistan	No	Yes	Lower-Middle	5.44
Papua New Guinea	No	Yes	Lower-Middle	No data
Philippines	No	Yes	Lower-Middle	5.64
Solomon Islands	No	Yes	Low	6.86
Sri Lanka	No	Yes	Middle	5.42
Thailand	No	Yes	Upper-Middle	5.82

I. International Frameworks for Anti-Money Laundering and Countering the Financing of Terrorism

The purpose of this section is to provide a broad overview of AML/CFT frameworks in the Asia-Pacific region. Such an overview illustrates how entrenched AML/CFT frameworks have become in the Asia-Pacific region as well as their origins in various international initiatives aimed at fighting financial crime. All selected Asia-Pacific jurisdictions have enacted legislation providing for AML/CFT frameworks, often in the form of a dedicated AML/CFT law (see Table 2 - AML/CFT Laws Among Select Asia-Pacific Jurisdictions). Such legislation typically provides for an AML/CFT regulatory framework that banks and other financial institutions must comply with or face increasingly severe penalties, including criminal sanctions.

International AML/CFT efforts originated in the 1980s to fight financial crime, estimated to cost the world economy \$1.45 trillion annually.² Financial crime encompasses all illegal activities that involve financial transactions. Financial crime has been defined as a deceptive way to manipulate an individual, organization, or economy for illegal financial gain by concealing the true nature of the activities. Terms like "fraud" and "white-collar crime" have been used interchangeably with financial crime.³ Many criminal activities revolve around cash generation that entails drug trafficking, corruption, fraud, tax evasion, market abuse, cybercrime, insider trading, embezzlement, and terrorism funding.⁴

Since illegal activities are mostly cash intensive, criminal entities devise new ways to convert proceeds of crime into seemingly legitimate proceeds. This process is known as money laundering (hereinafter "ML"). ML and terrorism financing (hereinafter "TF") have been identified as among the biggest threats to global security.⁵ Notably, the increasing trend of ML/TF, especially in the Asia-Pacific region, has been attributed to the rapid rise of digitalization which occurred during the COVID-19 pandemic.⁶

The increasing inflows and outflows of funds by money launderers is a threat to financial system stability of any country and can create liquidity challenges.⁷ The International Monetary Fund (hereinafter "IMF") has estimated that US\$2.17 trillion to US\$3.61 trillion is being laundered by the criminal entities every year.⁸ The staggering increase in complexity of financial crimes, amount of funds involved, and their impact on the global financial system led to the creation of FATF.⁹

Recognizing the global impact of ML, FATF was tasked with creating standards and formulating policies for effective implementation of regulatory, operational, and legal measures to combat ML/TF and other threats.¹⁰ In 1990, FATF issued a report on ML that included AML/CFT recommendations and suggested standards to enhance the integrity of the global financial system. These standards have been revised several times and currently take the form of FATF's 40 Recommendations.

² See Refinitiv (2018), https://www.refinitiv.com/content/dam/marketing/en_us/documents/reports/true-cost-of-financial-crime-latin-america-focus.pdf.

³ See Gottschalk, P, Categories of financial crime in Journal of financial crime (2010).

⁴ See Achim, M. V. and Borlea, S. N., Economic and Financial Crime: Corruption, shadow economy, and money laundering (Springer Nature, 2020)

⁵ See Global Crime Trend Report (INTERPOL, 2022), p.3.

⁶ Id. at 7.

⁷ See Aluko, A. and Bagheri, M., The impact of money laundering on economic and financial stability and on political development in developing countries: the case of Nigeria" (Journal of Money Laundering Control, 2012).

⁸ See Ofoeda, I., Anti-money laundering regulations and financial inclusion: Empirical evidence across the globe (Journal of Financial Regulation and Compliance, 2022).

⁹ See Deitz, A. J. and Buttle, J. R., Anti-money Laundering Handbook (2022), p. 10.

¹⁰ See Cox, D., Handbook of anti-money laundering (John Wiley & Sons, 2014). p.21.

BOX 1: FATF's 40 RECOMMENDATIONS

FATF's 40 Recommendations are standards around customer due diligence, verification of identity, know your customer, record keeping, reporting suspicious transactions, controlling cash movements, electronic transfer transactions, inter-banks correspondence, combating TF, and other rules related to effective compliance for mitigating ML/TF risks. The Recommendations can be divided into several areas: (1) AML/CFT policies and coordination, (2) preventive measures, (3) transparency and beneficial ownership of legal persons and arrangements, (4) responsibilities of competent authorities and other institutional measures, and (5) international cooperation. The risk averting compliance regime in the financial industry not only helps financial institutions to strengthen their operations in light of global standards, but also equips them to restrict criminal entities from misusing the financial system through ML and TF.

National AML/CFT frameworks are largely based on standards and guidance issued by FATF and other international organizations. FATF assesses a country's implementation and effectiveness of measures to combat ML/TF and proliferation which include the financial systems of member-States based on its Recommendations and produces Mutual Evaluation Reports. Although it is left to individual States and banks/financial institutions to structure and implement their own systems, three elements are virtually always present in AML/CFT frameworks: (1) customer due diligence (hereinafter "CDD"), (2) internal compliance, and (3) suspicious transactions reports.

While CDD is the most important preventive measure against ML/TF, it is also very onerous for banks and other financial institutions, particularly when the steps are required before the provision of a financial service. This is why it is most closely associated with de-banking (see Sections II-A and II-B for a discussion on the relationship between CDD and de-banking). CDD often entails an extensive collection and verification of documentation related to (1) the customer, (2) the beneficial owner, (3) the source of funds, (4) their purpose, and (5) the nature of the business. Know Your Customer (hereinafter "KYC") is the first step towards gathering and verifying information. It also has the most significant impact on de-banking (see Sections II-A and II-B for a discussion on the relationship between KYC and de-banking).

Several jurisdictions across the Asia-Pacific region have enacted legislation providing for AML/CFT frameworks, as reflected in Table 2. Such legislation is typically supplemented by regulations issued by a national authority overseeing domestic AML/CFT efforts. Notably, the IMF and the United Nations Office on Drugs and Crime adopted Model Legislation on Money Laundering and Financing of Terrorism in 2005.¹¹ Model Legislative Provisions on AML/CFT for common law legal systems were released in 2009 by IMF and the United Nations Office on Drugs and Crime, and updated in 2016. Such models have been implemented across the Asia-Pacific region.

¹¹ See Model Legislation on Money Laundering and Financing of Terrorism (2005), <https://www.imf.org/external/np/leg/amlcft/eng/pdf/amlml05.pdf>.

Table 2: AML/CFT Laws and Regulations Among Select Asia-Pacific Jurisdictions

Jurisdiction	AML / CFT Law
Cambodia	Law on Anti-Money Laundering and Combating the Financing of Terrorism (2007)
Indonesia	Law Prevention and Eradication of Money Laundering (2010) Act on Prevention of Transfer of Criminal Proceeds (2007)
Japan	Act on Punishment of Organized Crimes and Control of Crime Proceeds (1999) The Act on Special Provisions for the Narcotics and Psychotropics Control Act (1991)
Malaysia	Anti-Terrorism Financing and Proceeds of Unlawful Activities Act (2001) Anti-Money Laundering Ordinance (2007)
Pakistan	Control of Narcotics Substance Act (1997) Anti-Terrorism Act (1997) Anti-Money Laundering and Counter Terrorist Financing Act (2015) Criminal Code (Money Laundering and Terrorist Financing) (Amendment) Act (2015)
Papua New Guinea	Proceeds of Crime (Amendment) Act (2015) Mutual Assistance in Criminal Matters (Amendment) Act (2015) United Nations Financial Sanctions Act (2015)
Philippines	Anti-Money Laundering Act (2001)
Solomon Islands	Money Laundering and Proceeds of Crime (Amendment) Act (2010) Financial Transactions Reporting Act (2006)
Sri Lanka	Prevention of Money Laundering Act (2006) Conventions on the Suppression of Terrorist Financing Act (2005) Counter-Terrorism Financing Act (2016)
Thailand	Financial Institutions Business Act (2008) Anti-Money Laundering Act B.E. 2542 (1999)

FATF considers increasing financial inclusion as necessary to effectively combat financial crimes.¹² This is why FAFT has issued guidance that seeks to address financial inclusion issues caused by AML/CFT frameworks, discussed in the next section.

¹² See Impact Of The FATF Recommendations and Their Implementation on Financial Inclusion – Insights from Mutual Evaluations And National Risk Assessments (World Bank Group, 2021), <https://documents1.worldbank.org/curated/en/597781637558061429/pdf/Impact-of-the-FATF-Recommendations-and-their-Implementation-on-Financial-Inclusion-Insights-from-Mutual-Evaluations-and-National-Risk-Assessments.pdf>.

II. Solutions for Banks and Other Financial Institutions to Address De-Banking

The purpose of this Section is to summarize existing strategies that can be employed by banks and other financial institutions to prevent de-banking. This Section is divided into three subsections. Subsection A introduces de-banking and de-risking, summarizing their key elements and providing a specific example from the Pacific Islands. Subsection A also outlines the most problematic feature of AML/CFT compliance frameworks for traditionally underserved and excluded groups, which are KYC requirements imposed during the onboarding process for setting up an account.

Subsection B discusses the main strategies being implemented to address financial exclusion resulting from overly stringent KYC requirements, which include the application of the Risk-Based Approach and Simplified Due Diligence. Subsection B also discusses (1) National Risk Assessments of the selected Asia-Pacific jurisdictions with a specific example from Sri Lanka, (2) the three regulatory models for Simplified Due Diligence applied around the world, and (3) specific policy statements and strategies released by national governments to address de-banking/de-risking, particularly from the European Union and Australia.

Finally, Subsection C explains the concepts of regulatory technology for financial institutions (hereinafter "RegTech") and innovative technology in financial supervision (hereinafter "SupTech") and explains how these technologies can directly impact de-banking and financial inclusion. Examples of how technology is being used to address two major drivers of de-banking (identity verification and management, and AML compliance and detection) are included. The key takeaway is that technology can be effectively used to decrease the tension between financial crime and financial inclusion. Future work could inform the evolving use of technology to incorporate the evolution to risk-based compliance. Subsection C provides specific examples of how technology is used to address de-banking in Hong Kong, Malaysia, Pakistan, and the Philippines.

A. DEFINING DE-BANKING AND DE-RISKING

De-banking is a well-known concept in international development. Definitions typically contain at least two elements: (1) financial exclusion of traditionally underserved and excluded groups, (2) caused by the application of AML/CFT regulations. FATF defines de-banking as "the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage ML/FT risk."¹³ Similarly, the Australian Government has noted that de-banking "occurs when a bank declines to offer or withdraws banking services to a customer" due to AML/CFT laws and regulations.¹⁴

De-banking is closely related to de-risking. De-risking is used to describe a particular practice of banks and other financial institutions that results in de-banking. For instance, the World Bank Group has defined de-risking (similarly to de-banking) as the practice of banks and other financial institutions terminating or restricting business relationships with customers as a result of efforts to comply with increasingly stricter AML/CFT laws and regulations.¹⁵

De-banking and de-risking are widely known to have had unintended negative consequences on financial inclusion. The World Bank Group, for example, has highlighted that "[d]e-risking may threaten the progress that has been achieved on financial inclusion."¹⁶ Such progress includes the concerted efforts of international financial institutions, development agencies, and national

¹³ See High-Level Synopsis of the Stocktake of the Unintended Consequences of the FATF Standards (FATF, 2021), <https://www.fatf-gafi.org/content/dam/fatf-gafi/reports/Unintended-Consequences.pdf>.

¹⁴ See Government Response: Potential Policy Responses to De-banking in Australia (Australian Government, 2023), <https://treasury.gov.au/sites/default/files/2023-06/p2023-404377-gr.pdf>.

¹⁵ See De-Risking in the Financial Sector (World Bank Group), <https://www.worldbank.org/en/topic/financialsector/brief/de-risking-in-the-financial-sector/>.

¹⁶ Id.

governments to establish necessary financial infrastructure for increasing access to finance among traditionally underserved and excluded groups.

The key challenge for traditionally underserved and excluded persons is that they are often unable to meet the rigorous onboarding requirements of banks and other financial institutions seeking to comply with KYC regulations. As part of any AML/CFT compliance program, for example, a bank or other financial institution is required to collect information about potential customers and verify their identity and address.¹⁷ This practice is referred to as customer identification and verification – or KYC – and falls under the broader category of CDD (see also Section I for discussion of CDD and KYC). Although CDD contains other elements, KYC is considered the most immediately relevant aspect to MSMEs and other traditionally excluded groups.¹⁸ Accordingly, most AML/CFT-related initiatives that take into consideration financial inclusion focus on this element of the CDD process.

KYC requirements are especially problematic in States with large segments of the population that do not have official identity documents.¹⁹ This problem is particularly acute in the Asia-Pacific region.²⁰ In South Asia, for example, 32 percent of the population does not have an official identity.²¹ The ability of banks and other financial institutions to verify the identity of prospective customers is a necessary condition for financial inclusion, as without verifiable identities, such institutions cannot adhere to KYC requirements as provided for in AML/ CFT regulations.²² It is clear that KYC barriers are a significant impediment to the expansion and inclusiveness of the formal financial sector.²³

Some of the most publicized examples of de-risking involve the termination of correspondent banking relations, which can result in the de-banking of individual customers.

¹⁷ One common area that is subject to overregulation is the address verification requirements. Most countries tend to include this in their CDD requirements, although address verification is not required under the FATF Recommendations. Address verification is one the persistent barriers to financial inclusion. See also Ch. 4 in Access to Financial Services in South Africa: A brief case study of the effect of the implementation of the Financial Action Task Force Recommendations (Genesis Analytics, 2004), <https://www.findevgateway.org/sites/default/files/publications/files/mfg-en-case-study-access-to-financial-services-in-south-africa-a-brief-case-study-of-the-effect-of-the-implementation-of-the-financial-action-task-force-recommendations-2004.pdf>.

¹⁸ See Risk-Based Customer Due Diligence (CGAP, 2019), https://www.cgap.org/sites/default/files/publications/2019_10_Technical_Note_Risk_Based_Customer_DD.pdf.

¹⁹ See KYC Innovations, Financial Inclusion and Integrity In Selected AFI Member Countries (AFI, 2019), <https://www.afi-global.org/sites/default/files/publications/2019-03/KYC-Innovations-Financial-Inclusion-Integrity-Selected-AFI-Member-Countries.pdf>.

²⁰ Id.

²¹ Id.

²² Id.

²³ Id.

BOX 2: PACIFIC ISLANDS, DE-RISKING CORRESPONDENT BANKING RELATIONS

Correspondent banking is the provision of banking services by one bank to another for the purposes of currency exchange, the execution of third-party payments, trade finance and cross-border money transfers. Withdrawal of these relationships has been accelerating in the Pacific due to heightened attention to regulatory, reputational and financial risks from AML and CFT compliance. Between 2011 and 2022 there was a 60% decrease in correspondent banking relations in the Pacific. Given inconsistencies in AML/CFT compliance, regional commercial banks find it easier to close bank accounts of financial institutions to reduce the risk of penalties. According to the ADB, the Pacific banks' loss of correspondent banking services will reduce the range of trade and remittances services they will facilitate, "impact[ing] their incomes and their capacity to promote financial inclusion." Recent exits for correspondent banking are largely for the United States (US) dollar.

One of the key issues is that financial institutions in the Pacific have relied on time-consuming manual processes to undertake due diligence, monitor their customers, and report suspicious activities. Manual due diligence processes achieve inconsistent compliance with AML/CFT reporting requirements. Some of the initiatives to address de-banking in the Pacific include: (1) implementation of an electronic "Know Your Customer" facility, (2) reform of regulatory frameworks in line with revised FATF standards, (3) technical assistance provided by the Australian Transaction Reports and Analysis Centre, such as partnering with South Pacific financial intelligence units to implement the Australian-developed TAIPAN financial intelligence analytical system across the region. Notably, FATF issued guidance on correspondent banking relations in 2016.

B. EXISTING STRATEGIES AND GUIDANCE TO CURB DE-BANKING

The main strategy for addressing KYC barriers is the application of Simplified Due Diligence (hereinafter "SDD") to financial inclusion products determined to be "low risk."²⁴ Another strategy for addressing KYC barriers is leveraging technology to decrease the time and cost of compliance, discussed in Subsection C.²⁵ This strategy is consistent with the inherent flexibility built into the FATF framework that enables Members to not apply some of the FATF Recommendations provided that there is a low risk in relation to the type of transaction associated with the product, or where certain transactions are carried out on an occasional or limited basis²⁶.

SDD may be applied by banks and other financial institutions based on the risk profile of individual financial inclusion products, in line with the Risk-Based Approach (hereinafter "RBA"). Assessing the risk profile of individual products is of central concern in determining whether SDD (as well as outright exemptions) will be available to traditionally underserved and excluded groups when attempting to open an account to access financial services. Some examples of this strategy are listed below in Table 3.

²⁴ See Financial Integrity (World Bank Group), <https://www.worldbank.org/en/topic/financialmarketintegrity>.

²⁵ *Id.*

²⁶ Stanley, R. L., & Buckley, R. P. (2016). Protecting the west, excluding the rest: The impact of the AML/CTF regime on financial inclusion in the Pacific and potential responses. *Melb. J. Int'l L.*, 17, 83.

Table 3: Examples of Simplified Due Diligence for Financial Inclusion Products

Country	Target Segment	Products
UK	Survivors of modern slavery	HSBC UK Basic Bank Account ²⁷ with simplified due diligence that does not require valid proof of address
India	Customers who lack appropriate KYC documentation, including the homeless and the elderly	Aadhaar Digital ID – a government biometric based identification number that can be linked to bank accounts ²⁸
Philippines	Customers who have access to mobile phones, but no access to bank accounts	Smart money – a form of e-currency that allows mobile phone users to buy mobile credit, send and receive money domestically and internationally via mobile.

It is generally recognized that where ML/TF risks are lower, SDD should be used by banks and other financial institutions.²⁹ According to FATF, to address financial exclusion, banks and other financial institutions should move away from 'one size fits all' solutions and tailor their AML/CFT compliance frameworks to specific risk contexts.³⁰ In theory, implementation of RBA assists banks and other financial institutions in contributing to a more inclusive financial system by subjecting customers to simplified AML/CFT requirements (including, in some cases, exemptions) when attempting to access "low risk" products.³¹

A challenge here is that many national regulations do not allow RBA in the sense that a minimum level of customer information is to be collected and verified by financial institutions. For example, financial institutions are typically required to collect and verify the customer's name, address and date of birth. Yet some customers may face structural barriers or difficult circumstances that mean they cannot access or obtain standard identification documents, or they may have inconsistent personal details across their documents, such as name or date of birth. This may include customers living in remote areas, customers who have experienced natural disasters, customers who are victims of human trafficking, customers who are recent migrants, customer who have have recently been in prison, customers who have difficulty providing identification due to health or ageing-related reasons, among others. It is therefore essential that national authorities provide guidance to financial institutions about how the minimum level of information may be waived or alternative KYC arrangements may be implemented without fear of non-compliance. For example, AUSTRAC has developed clear guidance for the use of alternative identification that enables customers to use a wider scope of documents for customer identification, such as: referee statements, community ID, government correspondence and in the last resort self-attested statements for low-risk customers.³²

In 2021, the World Bank Group released a study on applying RBA in several jurisdictions. It concluded that one of the reasons for its slow uptake among banks and other financial institutions is that relevant guidance is too conservative and does not provide specific guidance on steps to be taken to onboard people who are currently financially excluded.³³ The World Bank Group recommended that FATF "reconsider its too cautious tone regarding simplifications and exemptions."³⁴ After a review of existing standards and guidance, the World Bank Group also found that guidance aimed at banks and

²⁷ <https://www.about.hsbc.co.uk/news-and-media/hsbc-uk-provides-support-for-survivors-of-human-trafficking>

²⁸ Carriere-Swallow, M. Y., Haksar, M. V., & Patnam, M. (2021). India's approach to open banking: some implications for financial inclusion. International Monetary Fund.

²⁹ See Guidance on Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion with a Supplement on Customer Due Diligence (FATF, 2017).

³⁰ Id.

³¹ Id.

³² AUSTRAC guidance "Assisting customers who don't have standard forms of identification"

<https://www.austrac.gov.au/business/core-guidance/customer-identification-and-verification/assisting-customers-who-dont-have-standard-forms-identification>

³³ Id.

³⁴ Id.

other financial institutions focusing solely on simplifications and exemptions is lacking and recommended that such a document be produced.³⁵ Importantly, it should be recognized that the initial priority should be on working with national regulators, especially those in developing jurisdictions where financial exclusion is a greater issue, to support their efforts to amend AML/CFT regulations in ways which integrate specific guidance on how to onboard those who struggle to access the financial services system. Formulating regulations which are in line with the guidance is a critical first step before there can be any meaningful expectation for banks or other financial institutions to follow suit and adopt more inclusive approaches for the underserved or unbanked.

One-way banks and other financial institutions evaluate ML/TF risk in line with RBA is through National Risk Assessments. National Risk Assessments help banks and other financial institutions identify, assess, and understand ML/TF risks, so that they can apply AML/CFT measures that correspond to the level of risk. The World Bank Group issued the Generic National ML/TF Risk Assessment Tool in 2015 that contains a Financial Inclusion Product Risk Assessment.³⁶ Financial Inclusion Product Risk Assessment serves as a model to develop risk-assessment frameworks that focus on the risk profiles of individual financial inclusion products. The World Bank Group recommends conducting an ML/TF risk assessment of existing or planned financial inclusion products as a standalone exercise by banks/financial institutions or under a State's National Risk Assessment.³⁷

BOX 3: SRI LANKA, FINANCIAL INCLUSION PRODUCTS RISK ASSESSMENT

The government of Sri Lanka included Financial Inclusion Product Risk Assessment in its 2021 National Risk Assessment that has the aim of "evaluating ML/TF risks stemming from both existing and new financial inclusion products." Sri Lanka's Financial Inclusion Product Risk Assessment entails: (1) summarizing the specific characteristics of individual financial inclusion products, (2) identifying the risks involved in applying simplified AML/CFT measures and (3) assessing the suitability of applying simplified AML/CFT measures to individual financial inclusion products. Importantly, the assessment also aims to inform policy formulation at the national level in line with Sri Lanka's National Financial Inclusion Strategy.

Sri Lanka's Financial Inclusion Product Risk Assessment evaluated ten categories of financial inclusion products, including: (1) regular savings and/or fixed deposits, (2) microloans, (3) group lending/self-help groups products, (4) SME loans, (5) deposit backed loan products/collateral savings, (6) money or value transfer/e-money services, (7) microinsurance, (8) finance leasing, (9) pawning, and (10) remittances or purchase/sale of foreign currency. Virtually all categories were ultimately assessed as "low risk" and therefore subject to SDD and simplified KYC requirements, not only given the size of the typical loans and transaction amounts, but also the existence of risk mitigants.¹ Sri Lanka's Financial Inclusion Product Risk Assessment paid particular attention to microloans, which is governed by the Microfinance Act of 2016. However, no attention was paid to loans secured by movable property, even though Sri Lanka adopted the Secured Transactions Act in 2009 and soon after established an electronic collateral registry.

³⁵ Id.

³⁶ See National Money Laundering and Terrorist Financing Risk Assessment Toolkit (World Bank Group), <https://www.worldbank.org/en/topic/financialmarketintegrity/brief/national-money-laundering-and-terrorist-financing-risk-assessment-toolkit-disclaimer-and-terms-of-use>.

³⁷ See supra at World Bank Group, fn. 15.

The table below summarizes National Risk Assessments among select Asia-Pacific jurisdictions. Although all selected jurisdictions have issued a National Risk Assessment, only a few contain an equivalent to Financial Inclusion Product Risk Assessment.

Table 4: National Risk Assessments Among Select Asia-Pacific Jurisdictions

Jurisdiction	Title	Financial Inclusion Product Risk Assessment
Cambodia	National Money Laundering and Terrorist Financing Report (2018)	Yes
Indonesia	Assessment of Money Laundering (2021)	No
Japan	National Risk Assessment of Money Laundering and Terrorist Financing (2014)	No
Malaysia	National Risk Assessment (2020)	No
Pakistan	National Risk Assessment on Money Laundering and Terrorism Financing (2019)	Yes
Papua New Guinea	Money Laundering and Financing of Terrorism National Risk Assessment (2017)	No
Philippines	National Risk Assessment on Money Laundering and Terrorism Financing (2011-2014)	Yes
Solomon Islands	Money Laundering and Financing of Terrorism Financing National Risk Assessment (2017)	No
Sri Lanka	National Money Laundering and Terrorist Risk Assessment (2021-2022)	Yes
Thailand	National Risk Assessment on Money Laundering, Terrorism Financing, and Proliferation of Weapons of Mass Destruction (2022)	No

A central question in the design of any risk-based framework for CDD is to what extent key decisions, such as the identification of lower-risk products and services and, on this basis, implementing SDD procedures, should be within the discretion of the provider of financial inclusion products.³⁸ In jurisdictions that have established regulatory frameworks that provide for SDD, three main approaches have been examined: (1) principles-based, (2) single lower-risk threshold, and (3) multi-tiered system.³⁹ The different approaches range from more discretionary (principles-based) to more prescriptive (multiple tiers) and are summarized below.⁴⁰

³⁸ Supra at CGAP, fn. 21.

³⁹ Id.

⁴⁰ Id.

Table 5: Models Of “Risk-Based” Regulatory Regimes

Principles Based	Single Lower-Risk Threshold	Multi-Tiered System
<p>In the principles-based approach, SDD processes are largely left to the discretion of banks and other financial institutions, as are risk classification methods. In enabling SDD, regulations may do little more than incorporate the broad language of the FATF Recommendations, leaving it largely to the discretion of banks and other financial institutions to determine when and how to apply it.</p> <p>The weakness of the discretionary approach comes in the tendency of banks and other financial institutions, especially those in less developed financial sectors, to take an overly conservative, overly compliant approach in order to avoid regulatory scrutiny and sanction.</p>	<p>Some countries define a single lower-risk threshold for all financial service providers or define thresholds for certain types of providers or services. This model represents a compromise where a bank or other financial institution can be assured that SDD is legally accepted in defined scenarios. Experience suggests that this assurance makes the use of SDD more likely within the defined threshold. In contrast, without such a threshold, excessively rigid compliance can take over, making it less likely that SDD will be used.</p> <p>In defined-threshold systems, the use of SDD beyond the threshold is sometimes prohibited by regulation, or in practice it may be discouraged because discretionary use exposes the bank of other financial institution to the risk of legal sanction. In this regard, a single threshold is inferior to a system of multiple tiers.</p>	<p>Another version of the prescriptive approach translates CDD into a series of graduated levels or tiers. These tiers accommodate different kinds of transactions, clients, and methods of account opening. There are typically three tiers: (1) basic, (2) medium, and (3) full. A tiered system can provide banks and other financial institutions a degree of certainty in reaching out to underserved clients. In sectors with large unbanked populations, this approach is more effective compared to discretionary frameworks. The key advantage of a multi-tiered framework over a single threshold is the opportunity it affords to incorporate differentiation and nuance to account for a wide range of needs.</p> <p>Compared with a principles-based framework, a prescriptive system of bright-line rules and tiers increases complexity and rigidity. In some instances, it may also increase costs. The defined threshold or tiers may be at odds with many internal risk guidelines of banks and other financial institutions.</p>

Decision frameworks for banks and other financial institutions to evaluate the tradeoff between managing AML/CFT risk and financial inclusion is largely determined by the regulatory regime they are subject to, as outlined above. Notably, lower-income States appear to provide more discretion to banks and other financial institutions to apply SDD (under the principles-based approach) instead of predefining lower-risk situations in which SDD can be applied (under the tiered approach).⁴¹ However, data confirms that most of the time, this discretion is not exercised by financial institutions in those States.⁴² In fact, the use of SDD and/or exemptions decreases with the income level of a State, although financial exclusion remains the highest in lower-income States where such measures are most needed.⁴³

Some governments at the national and regional levels have developed strategies and plans to address de-banking, as reflected in Table 6 below. Virtually all contemplate enhanced implementation of RBA and SDD exemptions to reduce de-banking. Although some have offered guidance to banks and other financial institutions on the application of RBA and SDD, such guidance is of a very general nature.⁴⁴ The European Banking Authority has released the most guidance relevant to de-banking/de-risking. Notably, the European Banking Authority recommended that banks and other financial institutions adjust the focus of their supervisory regime on the management of risks associated with particular products or services, including financial inclusion products.

⁴¹ See supra at World Bank Group, fn. 15.

⁴² Id.

⁴³ Id.

⁴⁴ See Dru Stevenson, Operation Choke Point: Myths and Reality (Administrative Law Review, 2022) (“regulators provide[] no specific guidance about how to strike the proper balance, or where to draw a line in risk assessment”), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4292272.

Table 6: National and Regional Strategies Related to De-Banking

Issuing Authority	Title	Aims/Recommendations
Arab Monetary Fund	De-Risking and Financial Inclusion: Global trends and Thoughts for Policy Debate for the Arab Region (2018)	Formulation of provisional areas for further consideration, including (1) enhancing coordination and collaboration among standard-setting bodies on financial inclusion, (2) broader understanding of country context, (3) concept of proportionality applied to financial inclusion, (4) supporting innovation, and (5) increasing transparency through community-driven compliance solutions.
Australian Treasury	Government Response: Potential Policy Responses to De-Banking in Australia (2023)	Crafting recommendations to address de-banking in Australia, such as (1) data collection, (2) transparency and fairness measures, (3) guidance with respect to digital currency exchanges, FinTech, and remittances sectors, and (4) capability uplift.
Caribbean Development Bank	Strategic Solutions To 'De-Risking' And the Decline of Correspondent Banking Relationships in The Caribbean (2016)	Development of solutions and mitigants to the problems arising from restriction of financial services and withdrawals of correspondent banking relationships in the Caribbean, including (1) regional high-level diplomacy, (2) regional and national centralized information repository/database, (3) centralized regional transactions hub, (4) FATF and Basel AML Guidance, (5) consultancies on operational and technical profile, (6) KYC utilities, and (7) legal entity identifiers.
European Banking Authority	Opinion on De-Risking (2022)	Summarize initiatives competent authorities can take to address de-risking in the EU, such as: (1) assessing the scale of de-risking at the national level, (2) dedicated guidance to institutions that make decisions to de-risk, (3) ensuring the regulatory expectations are clear for all parties, (4) establish multi-stakeholder dialogue to mitigate financial exclusion, and (5) and ensuring effective application of the right to basic banking accounts in line with AML/CFT requirements.
European Banking Authority	Guidelines on Risk-Based Supervision (2016)	Offer guidance to competent authorities at the national level for implementation of risk-based supervision, including adjustments to: (1) the nature of supervision, for example, by adjusting the ratio between off-site and on-site supervision, (2) the focus of supervision, for example by focusing on the management of risks associated with particular products or services, or on specific aspects of the AML/CFT processes such as customer identification, risk assessment, ongoing monitoring and reporting activities, (3) the frequency of supervision, for example by monitoring key indicators less often where the risks are reduced, and (4) the intensity and intrusiveness of supervision, for example by determining, according to risk, the extent of customer file reviews, sample testing of transactions and suspicious transactions reports conducted on-site.
Hong Kong Monetary Authority	De-risking and Financial Inclusion (2016)	Articulate guiding principles for implementation of RBA in relation to CDD for licensed banks and other financial institutions, such as: (1) risk differentiation, (2) proportionality, and (3) no "zero failure" regime.
Pacific Islands Regional Initiative	Regional De-Risking Action Plan (2021)	Implement action plan so that an increased number of Pacific banks can retain and/or maintain correspondent banking relationships, such as through: (1) inter-regulator and stakeholder coordination, (2) diagnostics and monitoring frameworks to track implementation progress, (3) compliance with AML/CFT standards and risk assessment, and (4) technology-based solutions.

Identification of proposals that would help reduce any unnecessarily burdensome regulatory requirements, including: (1) considering revisions to AML/CFT programs as required under law and regulations, (2) considering the support of financial inclusion through the application of a Risk-Based Approach to AML/CFT compliance, and (3) continuing public-private sector engagement.

BOX 4: AUSTRALIA, GOVERNMENT MEASURES TO COMBAT DE-BANKING

Consistent with national de-banking strategy, the Australian Government, including the Council of Financial Regulators, Treasury and The Australian Transactions Report and Analysis Centre, are in the process of carrying out a de-banking strategy that focuses on getting banks and other financial institutions to implement various “transparency and fairness measures.” The five measures include: (1) documenting the reasons for de-banking a customer, (2) providing the customer with these reasons, (3) providing de-banked customers with access to Internal Dispute Resolution procedures, (4) providing customers with 30 days’ notice before de-banking a customer, and (5) ensuring that banks certify adherence to measures 1-4.

The proposed measures were designed to prevent cases, such as Beyond Bank Australia Ltd. (BBA), that attempted to de-bank Human Appeal International Australia (Human Appeal), a registered charity, under a clause in its terms and conditions which allowed it to close any account without giving a reason. BBA justified the closure of the accounts due to the alleged volume and complexity associated with reviewing the transactions from Human Appeal, increasing the burden on its AML/CTF team. Ultimately, an Australian Court ruled in the highly publicized case of *Human Appeal International Australia v Beyond Bank Australia Ltd (No 2) [2023] NSWSC 1161* that the account closure was invalid as BBA had not provided reasons sufficient to demonstrate that it had a legitimate commercial basis to de-bank Human Appeal. Notably, FATF has recently issued guidance on financial inclusion and non-profit organizations.

C. ROLE OF DIGITAL TECHNOLOGY IN ADDRESSING DE-BANKING

Digital technology also offers ways to mitigate de-risking pressures when complemented with reforms and increased supervisory capacity. The G20 High-Level Principles for Digital Financial Inclusion contain suggested actions to help avoid negative impacts on financial inclusion caused by de-risking. Many governments, for example, are investing in more comprehensive and technologically enabled national identity systems featuring biometrics, uniform ID cards, and digital ID platforms. Increasingly, financial institutions are using national ID databases to conduct electronic KYC instead of reviewing hardcopy documents to verify identification. This should reduce the need to hire specialists to respond to the regulatory pressure to tackle money laundering and terrorist financing.

Financial inclusion is one of the primary goals of international financial institutions/development agencies and domestic regulatory authorities. According to the G20 High Level Principles for Digital Financial Inclusion, one of the ways to accomplish financial inclusion is to promote digitally enabled access to financial products and services.⁴⁵ Financial technology (or “FinTech”) firms have been at the forefront of this effort providing a wide range of apps, software or other technology services which enable users to access financial services. FinTech companies have proliferated and are expected to grow to a US\$1.5 trillion industry by 2030, with the Asia-Pacific region expected to become the largest FinTech market, led by emerging economies.⁴⁶

The growth of FinTech has resulted in the rise of innovative solutions to financial exclusion. The cost of traditional banking products is much higher than those offered by FinTechs and through platforms. Digital technology has facilitated the deployment of various financial services by platforms, a product known as “embedded lending”. The ML and related challenges are addressed through data analytics and by digital technology experts. Instead of the traditional costly monitoring of business activities, technological solutions such as Oracles may be deployed to automatically source and feed data to the

⁴⁵ See The G20 High-Level Principles for Digital Financial Inclusion (GPAC, 2016), <https://www.gpfi.org/sites/gpfi/files/documents/G20%20High%20Level%20Principles%20for%20Digital%20Financial%20Inclusion%20-%20Full%20version-.pdf>.

⁴⁶ See BCG “Fintech Projected to Become a \$1.5 Trillion Industry by 2030” (BCG, May 3, 2023) <https://www.bcg.com/press/3may2023-fintech-1-5-trillion-industry-by-2030>.

provider of funding. These alternative products increase the competition in the entire market and incentivize the policymakers to re-imagine the approach of subsidizing compliance costs. It is important to nurture and support such alternatives, but their funding may need to come from the banking sector, which may face regulatory challenges. The absence of these alternatives

One way to decrease the perceived risk of financial inclusion products is through regulation technology (RegTech) and supervisory technology (SupTech/RegTech for Regulators). RegTech involves new technologies to help regulators (see below) and financial service providers streamline back-office functions, enhance productivity, and overcome regulatory challenges, such as the risks and costs related to compliance obligations. SupTech involves technology-based solutions and data science that can help financial authorities regulate and supervise the marketplace more effectively and efficiently.⁴⁷

The financial services industry is evolving rapidly and has changed tremendously in the past decade, with non-bank entrants gaining significant traction globally. As many emerging economies strive to accelerate financial inclusion, especially for vulnerable groups such as women, youth, and MSMEs, the introduction of digital financial services has assisted individuals and businesses in accessing and using financial services with ease. This paradigm shift in the industry presents new regulatory and supervisory challenges for financial authorities. For example, they need to comprehend and mitigate prevailing and emergent risks associated with technology, such as cybersecurity, AML/CFT, fraud detection, compliance reporting, outsourcing, and the use of third parties. In addition, as the regulators work on their broad mandate to ensure monetary and financial stability, expanding access through responsible usage of digital financial services for the under and unserved market segments has become imperative.⁴⁸ SupTech solutions can support financial authorities in implementing their mandates related to financial stability, integrity, inclusion, and consumer protection (see the example from Hong Kong below in Box 5). As one regulator put it, "the modernization of supervisory activities should go hand-in-hand with the adoption of AML/CFT RegTech by the private sector."⁴⁹

In particular, financial marketplaces are expanding rapidly and becoming increasingly complex. SupTech provides solutions that strengthen the capacity of the financial authorities to:

- Monitor providers, channels, and products, by improving and increasing the volume, variety, speed, and accuracy of data available to the financial authorities. This data is essential to drive risk-based supervision, for the implementation of mechanisms to facilitate innovation (e.g., regulatory sandboxes), and for the development of proportional regulations. This is critical to achieve healthy financial inclusion.
- Establish a direct relationship with users, creating a direct information feedback loop to better understand their behaviors and needs, and new avenues for recourse and escalation that increase trust in public authorities and the formal financial sector.
- Standardize processes and tools to make it easier for financial authorities to coordinate cross-country and cross-sector supervision.⁵⁰

⁴⁷ See United Nations Secretary-General's Special Advocate for Inclusive Finance for Development "Briefing on Regtech for Regulators" (UNSGSA, 2020) <https://www.unsgsa.org/sites/default/files/resources-files/2020-09/RegTech.pdf>.

⁴⁸ See Regulatory and Supervisory Technologies For Financial Inclusion (AFI, 2022 (February)) https://www.afi-global.org/wp-content/uploads/2022/02/RegTech_SupTech_special_report_isbn.pdf.

⁴⁹ See Hong Kong Monetary Authority AML/CFT Regtech: Case Studies and Insights (HKMA, 2021) <https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2021/20210121e1a1.pdf>.

⁵⁰ See United Nations Secretary-General's Special Advocate for Inclusive Finance for Development, Briefing on Regtech for Regulators (UNSGSA, 2020), <https://www.unsgsa.org/sites/default/files/resources-files/2020-09/RegTech.pdf>.

SupTech is in much earlier stages of adoption versus RegTech and so this Subsection will focus much more on the immediate potential impact of RegTech.⁵¹ In fact, RegTech is a rapidly growing industry expected to reach US\$16 billion in 2025 from \$6.3 billion in 2020.⁵² According to the Global RegTech Industry Benchmark Report, RegTech vendors may be categorized into various market segments.⁵³ Such segments include: (1) identity verification and management, (2) regulatory compliance and change management, (3) regulatory reporting and case management, (4) risk analysis and management, (5) transaction monitoring and screening, (6) AML compliance and detection, and (7) fraud detection and prevention.⁵⁴ RegTech can be of use to decrease de-banking by shrinking a financial institution's cost of compliance via efficiencies as well as decrease the perceived risk of customers (whether individuals or MSMEs) by financial institutions/regulators. From the list above, those areas that connect directly to the previous discussions in this White Paper are identity verification and management (e-ID/e-KYC) and AML compliance and detection. The below are just a few examples in the Asia-Pacific region where technology is being used to address these two most important issues:

BOX 5: HONG KONG, FRAUD DETECTION WITH MACHINE LEARNING

An HK Bank operates a rules-based fraud monitoring solution but has implemented Machine Learning (ML) to supplement its rules-based fraud detection, to improve the false-positive alert rate – reducing friction in the customer experience and improving operational efficiency. This Bank's ML ingests around 300 data elements and considers a range of suspicious event indicators including flow-of-funds, beneficiary account behavior, and customer demographics. The Bank has implemented Machine Learning to supplement its rules-based fraud detection platform. The ML runs against payments data in parallel to the rules-based fraud detection system, and the outputs of both are compared against a decision matrix to determine an overall risk score. Based on the risk score, payments can be auto blocked, delayed for review, or auto released. Through this approach, the Bank has not only reduced its false-positive alert rate but has also been able to identify confirmed fraud cases that would have earlier gone undetected. Around 20% of the Bank's low-risk alerts are now auto-released.

BOX 6: MALAYSIA, IDENTITY VERIFICATION ALTERNATIVES

With respect to customer identification/identity verification challenges, Malaysia has started to accept birth certificates and passports as means of identification for Malaysian citizens and, for non-citizens, they now accept refugees' cards, student cards, work permits and letters from colleges or universities. Persons can also use their employee address as a residential address if they live in rural areas which lack a proper address. Malaysia's government also requires providers of Money and Transfer Value Services to register with a designated competent authority. Malaysia has a similar arrangement as Mexico in that financial institutions are required to establish systems and mechanisms that allow them to receive online all transactions made through an agent in the same way as those carried out in banking offices.

BOX 7: PAKISTAN, BIOMETRIC NATIONAL IDENTITY FOR OPENING ACCOUNTS

Pakistan has started integrating biometric national identity for opening accounts and registering for SIM cards. This allows for branchless banking, and low-income persons can open Level-0 accounts that provide basic financial services with lower transaction limits. Pakistan has also used the Financial Inclusion Product Risk Assessment tool in their National Risk Assessment.

⁵¹ Nevertheless, there has been recent guidance published on SupTech, including Adopting SupTech for Anti-Money Laundering: A Diagnostic Toolkit (BFA, 2020), <https://bfaglobal.com/wp-content/uploads/2020/06/R2A-AML-SupTech-Toolkit-04June2020-1.pdf>.

⁵² See Global Fintech 2023: Reimagining the Future of Finance (BCG, 2023) <https://www.bcg.com/publications/2023/future-of-fintech-and-banking>

⁵³ See Global RegTech Industry Benchmark Report (University of Cambridge – Centre for Alternative Finance, 2023), <https://www.jbs.cam.ac.uk/wp-content/uploads/2020/08/2019-12-ccaf-global-regtech-benchmarking-report.pdf>.

⁵⁴ See Unit 21 “Top 7 Regtech Use Cases in the Financial Sector” (Unit 21 July 28, 2022) <https://www.unit21.ai/blog/regtech-use-cases>

BOX 8: PHILIPPINES, DE-BANKING INITIATIVES

Following the 2013 typhoon, the Central Bank of the Philippines provided regulatory relief packages to all banks with included a relaxation of identification requirements. Banks could accept written certification from client that they had lost their IDs as a result of the typhoon. The Philippines has attempted to use the Financial Inclusion Risk Assessment tool in their National Risk Assessment. In the Philippines, all agents at financial institutions are required to adhere to AML/CFT laws and regulations on monitoring and reporting suspicious transactions. The Philippines allow Barangay Certifications, which are certificate issued by village masters. They also allow several other forms of identification, but they must be issued by official authorities of the Republic of Philippines. The Philippines is also developing electronic passport technology.

III. EFFECT OF DE-BANKING ON GLOBAL FINANCIAL INCLUSION EFFORTS

This Section suggests that international development programs specifically aimed at expanding access to finance (through the design and deployment of various financial inclusion products) need to consider the issue of de-banking adequately. The purpose of this Section is to summarize the existing financial inclusion landscape in the Asia-Pacific region with a focus on the enabling legal and regulatory environment that supports the deployment of financial inclusion products.

Although de-banking is an issue for businesses and individuals alike, much of the focus lately has been on how de-banking impacts businesses,⁵⁵ particularly micro-, small- and medium-sized enterprises (hereinafter “MSMEs”). Micro-businesses typically operate as sole proprietorships managed by an individual, so the many de-banking issues affecting individuals also apply to micro-businesses and vice versa. In the Asia-Pacific region, MSMEs significantly contribute to economic growth and job creation.⁵⁶ They comprise 96% of businesses and account for two out of every three private sector jobs.⁵⁷ Addressing the needs of MSMEs thus has the potential to impact the region's poor and vulnerable more broadly.

This Section emphasizes the role of international financial institutions and development agencies in supporting States to reform their legal and regulatory frameworks with the aim of expanding access to finance to MSMEs and other traditionally credit-deprived groups. One of the key takeaways is that development programs that aim to establish an enabling legal and regulatory environment for deploying various financial inclusion products (including those enabled by a modern secured transactions law) have not adequately addressed potential barriers caused by overly stringent AML/CFT regulations. One of the consequences is the accumulation of risks in the financial sector, such as overconcentration of risks within the particular sector or business segment. Instead of being included within a newly modernized financial sector, MSMEs may be pushed to the shadow lending sector that operates outside the regulatory perimeter and where risks may grow uncontrollably.

This Section is divided into three subsections. Subsection A defines key concepts, such as “financial inclusion” and “financial exclusion,” closely related to de-banking/de-risking. These definitions are based on the various policy statements and reports published by international financial institutions and development agencies, such as the UN, World Bank Group, and ADB. Subsection B explains the role of such institutions and agencies in supporting financial inclusion in the Asia-Pacific region through the development of the financial sector and the establishment of necessary financial infrastructure. Subsection B pays particular attention to the role of National Financial Inclusion Strategies. Although virtually all National Financial Inclusion Strategies considered in this Section seek to promote an enabling legal and regulatory environment for the deployment of financial inclusion products, none deal specifically with the issue of de-banking/de-risking. Subsection C discusses the implementation of National Financial Inclusion Strategies across the Asia-Pacific region, particularly through the adoption of secured transactions laws and the establishment of electronic collateral registries. This Subsection suggests that development programs to establish a legal and regulatory framework designed to increase access to finance integrate AML/CFT considerations into their design.

⁵⁵ See, e.g., SMEs at Risk from Bank De-risking (ACT, 2023), <https://www.treasurers.org/hub/treasurer-magazine/smes-risk-bank-de-risking-says-fca>.

⁵⁶ See Small and Medium-Sized Enterprises Lending Approaches: The Role of Banks in Asia (United Nations Economic and Social Commission for Asia and the Pacific, 2022), <https://www.unescap.org/kp/2022/small-and-medium-sized-enterprises-lending-approaches-role-banks-asia>.

⁵⁷ Id.

A. FINANCIAL INCLUSION IN THE INTERNATIONAL DEVELOPMENT CONTEXT

The UN Sustainable Development Goals aim to eliminate global poverty, which directly relates to financial inclusion. It has been estimated that more than half of the world's working adults (2.5 billion) are excluded from formal financial services.⁵⁸ Lack of access to financial services is most acute among low-income populations in developing countries, where approximately 80% of poor people are excluded.⁵⁹ According to the World Bank Group, the Asia-Pacific region accounts for half of the world's unbanked.⁶⁰ There is no universally recognized definition of financial inclusion. The financing section of the UN Department of Social and Economic Affairs defines it as "universal access, at a reasonable cost, to a wide range of financial services, provided by a variety of sound and sustainable institutions."⁶¹

Financial exclusion refers to businesses and individuals without access to common financial services such as savings accounts, loans, cashless transactions, and credit.⁶² Businesses and individuals are often excluded because they are unable to meet the requirements of a formal financial institution,⁶³ particularly AML/CFT requirements related to CDD, such as KYC (see Sections I and II for further discussion of CDD and KYC). De-banking is a type of financial exclusion that occurs as a result of AML/CFT requirements that have minimum standards which don't consider the needs of the excluded. As a result, banks and other financial institutions are put under pressure to avoid rather than mitigate risk. This has resulted in a tradeoff between complying with AML/CFT requirements, on the one hand, and increasing access to finance for MSMEs and other traditionally excluded groups, on the other hand.⁶⁴

The UN has identified certain groups that are most impacted by financial exclusion. Such groups include (1) women, (2) youth, (3) migrants, (4) refugees, (5) farmers, and (6) indigenous communities.⁶⁵ Members of these groups may also be owners of MSMEs. For example, many financial inclusion programs aim to increase access to finance for women-owned MSMEs.⁶⁶ Similarly, there are also many development programs that promote indigenous entrepreneurship and job creation through increased access to credit for indigenous-owned MSMEs.⁶⁷ According to ADB, nearly three-quarters of the world's indigenous communities live in the Asia-Pacific region, where access to finance remains a serious hurdle to development.⁶⁸

Food insecurity caused by the lack of access to finance also remains a challenging problem. The World Bank Group has identified expanding access to agricultural finance among smallholder farmers in remote, rural areas as key to increasing wealth and facilitating the development of food value chains in line with UN Sustainable Development Goals.⁶⁹ Notably, the Global Partnership for Financial

⁵⁸ See Half the World is Unbanked (Financial Access Initiative, 2009), https://www.findevgateway.org/sites/default/files/publications/files/mfg-en-paper-half-the-world-is-unbanked-oct-2009_0.pdf.

⁵⁹ Id.

⁶⁰ See Global Findex Database (World Bank Group, 2015), <https://www.worldbank.org/content/dam/Worldbank/Research/GlobalFindex/PDF/N2Unbanked.pdf>. See also Financial Inclusion in Asia Country Surveys (ADB, 2014), <https://www.adb.org/sites/default/files/publication/159308/adb-financial-inclusion-asia.pdf>.

⁶¹ See Inclusive Finance (UN), <https://www.un.org/esa/ffd/topics/inclusive-local-finance/inclusive-finance.html>.

⁶² See What Is Financial Exclusion? (FINCA, 2020), <https://finca.org/blogs/what-is-financial-exclusion>.

⁶³ Id.

⁶⁴ See, e.g., Financial Inclusion not Exclusion: Managing De-Risking (World Bank Group, 2016) ("De-risking practices by global financial institutions threaten to cut off access to the global financial system for remittance companies and local banks in certain regions, putting them at risk of losing access to the global financial system"), <https://www.worldbank.org/en/events/2016/10/07/financial-inclusion-not-exclusion-managing-derisking>.

⁶⁵ See Inclusive Digital Economies (UN), <https://www.unCDF.org/inclusive-digital-economies>.

⁶⁶ See Supporting Women-owned MSMEs (WTO, 2023), https://www.wto.org/english/tratop_e/msmes_e/uk_presentation_supporting_women_owned_msme.pdf.

⁶⁷ See Linking Indigenous Communities with Regional Development (OECD, 2019), <https://www.oecd-ilibrary.org/sites/1c3c6d6a-en/index.html?itemId=/content/component/1c3c6d6a-en>. Much emphasis has been placed on expanding access to financial services to indigenous communities as of late, including through reducing regulatory barriers arising from AML/CFT requirements.

⁶⁸ See Indigenous Peoples Safeguards (ADB), <https://www.adb.org/who-we-are/safeguards/indigenous-peoples>.

⁶⁹ See Agriculture Finance & Agriculture Insurance (World Bank Group), <https://www.worldbank.org/en/topic/financialsector/brief/agriculture-finance>.

Inclusion identified compliance with AML/CFT requirements as a core regulatory issue affecting access to agricultural finance among smallholder farmers.⁷⁰

B. INTERNATIONAL AND REGIONAL SUPPORT

International financial institutions, development agencies, and standard setters support a range of initiatives to increase financial inclusion through programs that facilitate financial sector development. The World Bank Group defines financial sector development as “the set of institutions [...] as well as the legal and regulatory framework that permit financial transactions.”⁷¹ Financial sector development entails the establishment of financial infrastructure. Financial infrastructure refers to the set of laws and institutions that enable efficient and effective access to finance through (1) insolvency and debt resolution, (2) secured lending on movable property, and (3) credit reporting.⁷² Creating an enabling legal and regulatory environment in these three areas has been shown to increase financial inclusion through the diversification of financial products and services as well as the improvement of risk management.⁷³

The development and implementation of National Financial Inclusion Strategies is the mechanism commonly used by governments to support establishment of financial infrastructure at the national level, including in the Asia-Pacific region.⁷⁴ International financial institutions and development agencies partner with financial authorities, such as central banks to implement development programs aimed at financial inclusion.⁷⁵ The ADB has provided technical assistance in its countries of operation for the development of National Financial Inclusion Strategies. For example, in 2017, the ADB assisted the Bureau of Financial Inclusion Policy and Development in Thailand in developing a National Financial Inclusion Strategy (see Table 6 – National Financial Inclusion Strategies Among Select Asia-Pacific Jurisdictions).⁷⁶

Many National Financial Inclusion Strategies emphasize the importance of adopting enabling legal and regulatory frameworks for secured transactions, including the establishment of electronic collateral registries.⁷⁷ Secured transactions frameworks can incentivize banks and other financial institutions to offer financial inclusion products by providing clear and predictable rules for the creation, third-party effectiveness (perfection), priority and enforcement of security rights in the types of movable collateral (e.g. crops, equipment, inventory and receivables) commonly held by MSMEs and other traditionally excluded groups. However, none of the National Financial Inclusion Strategies considered here specifically addresses the challenges posed by AML/CFT regulations to the uptake of financial inclusion products enabled by a secured transactions framework (as outlined above), much less the issue of de-banking/de-risking more broadly. It has therefore been

⁷⁰ See New Trends in Agricultural Finance (GPFI, 2015), <https://www.gpfi.org/sites/gpfi/files/documents/02-New%20Trend%20Agricultural%20Finance%20Report-Final-LowRes.pdf>.

⁷¹ See Financial Development (World Bank Group), <https://www.worldbank.org/en/publication/gfdr/gfdr-2016/background/financial-development>.

⁷² See Credit Infrastructure (World Bank Group), <https://www.worldbank.org/en/topic/creditinfrastructure>.

⁷³ Id.

⁷⁴ Recognizing the importance of developing National Financial Inclusion Strategy, the UN published in 2018 the Toolkit on Developing and Operationalizing a National Financial Inclusion Strategy and National Financial Inclusion Strategies: Current State of Practice. See Toolkit on Developing and Operationalizing a National Financial Inclusion Strategy (UN, 2018), https://sdgs.un.org/sites/default/files/publications/2688NATIONAL_FINANCIAL_INCLUSION_STRATEGY_Toolkit.pdf. See also National Financial Inclusion Strategies: Current State of Practice (UN, 2018), https://sdgs.un.org/sites/default/files/publications/2679National_Financial_Inclusion_Strategies.pdf.

⁷⁵ See David Bholat et al, Financial inclusion and central banks (Bank of England) (“Many central banks across the globe provide useful examples of what can be done to promote greater inclusion. Some central banks collect valuable data on financial exclusion in order to establish evidence on what works. Others provide financial literacy training to improve the usage of financial services or promote better infrastructure to reach the excluded.”), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2671740. See also Bruno Tissot et al, Measures of financial inclusion - a central bank perspective (BIS, 2017), https://www.bis.org/ifc/publ/ifcb47q_rh.pdf.

⁷⁶ See Thailand: Development of a Strategic Framework for Financial Inclusion (ADB, 2017), <https://www.adb.org/sites/default/files/project-documents/45128/45128-001-tcr-en.pdf>.

⁷⁷ Electronic collateral registries facilitate the publication of the rights of creditors in movable collateral of the borrower. Electronic collateral registries have been shown to increase the availability and decrease the cost of credit for MSMEs and other traditionally excluded groups.

recommended to consider AML/CFT regulations in future National Financial Inclusion Strategies,⁷⁸ including suggestions on how to align such regulations with secured transactions and other applicable commercial law frameworks.

Table 7: National Financial Inclusion Strategies Among Select Asia-Pacific Jurisdictions

Jurisdiction	Authority	Title	Key Recommendations
Cambodia	National Bank of Cambodia	Financial Sector Development Strategy 2011-2020	Establish the legal and regulatory framework for financial sector infrastructure, as well as accounting and auditing, the payment system, the system for recording collateral, and the credit bureau.
Indonesia	Bank of Indonesia	National Financial Inclusion Strategy of 2016	Consider developing a focused strategy for agricultural value-chain financing and a movable collateral registry to benefit small businesses, farmers, and women.
Japan	SME Agency	Japan has a long history of supporting financial inclusion through policies aimed at supporting SMEs, including as reflected in the SME Basic Act (last amended in 1999)	Currently, the Japanese government is working on the reform of its secured transactions law.
Malaysia	Central Bank of Malaysia	Financial Sector Blueprint 2022-2026	Support efforts to expand the collateral base for SME financing, including via the establishment of a centralized collateral registry. This registry is envisioned to allow one-stop registration of all security interests in assets, which in turn, supports more reliable credit appraisals.
Pakistan	State Bank of Pakistan	National Financial Inclusion Strategy of 2015	Create a secured transactions framework and electronic collateral registry for movable collateral and allow for enforcement of rights in collateral outside of the slow and unpredictable judicial system.
Papua New Guinea	Bank of Papua New Guinea	National Financial Inclusion Strategy 2014-2015	Implement secured transactions framework with online registry.
Philippines	Central Bank of the Philippines	National Strategy for Financial Inclusion 2022-2028	Establish the financial infrastructure (e.g., credit guarantees, credit information registry) and legal frameworks (e.g., secured transactions framework) aimed at reducing the risks and associated costs of serving agriculture and MSME clients.
Solomon Islands	Central Bank of Solomon Islands	National Financial Inclusion Strategy 2021-2025	Create a legal and regulatory environment to increase usage of financial services.
Sri Lanka	Central Bank of Sri Lanka	National Financial Inclusion Strategy 2021-2024	Institute strong financial infrastructure, for example, credit bureaus, payments systems, and collateral registries, which can help financial services providers evaluate customers effectively, provide affordable products, and reach remote consumers via low-cost channels. Efforts are already underway in Sri Lanka to expand the existing credit information system and secured transactions framework.
Thailand	Bank of Thailand	Financial Sector Master Plan 2016-2020	Support the effort to expand the types of assets that may be used as collateral.

⁷⁸ See Inclusive Financial Integrity: A Toolkit for Policymakers (AFI), https://www.afi-global.org/sites/default/files/publications/2020-07/AFI_CENFRI_toolkit_AW_digital.pdf.

C. IMPLEMENTATION OF NATIONAL FINANCIAL INCLUSION STRATEGIES

A key component of implementing National Financial Inclusion Strategies is the adoption of secured transactions laws and the establishment of electronic collateral registries. International financial institutions, such as the World Bank Group and ADB, have supported relevant reforms in line with international standards across the Asia-Pacific region.⁷⁹ Recently, for example, the ADB has supported secured transactions reform in several Pacific Island jurisdictions,⁸⁰ such as Papua New Guinea and the Solomon Islands (See Table 7 – Secured Transactions Laws and Collateral Registries Among Select Asia-Pacific Jurisdictions).⁸¹

Table 8: Secured Transactions Laws Among Select Asia-Pacific Jurisdictions:

Jurisdiction	Title	Electronic Collateral Registry
Cambodia	Law on Secured Transactions (2007)	Yes
Indonesia	Various statutes form the secured transactions framework, including the Fiduciary Security Act (1999) and Civil Code	No
Japan	Various statutes form the secured transactions framework, including the Civil Code and Act of Registration	No
Malaysia	Various statutes form the secured transaction framework, including the Companies Act (1965) and Bill of Sale Act (1950)	No
Pakistan	Financial Institutions (Secured Transactions) Act (2016)	Yes
Papua New Guinea	Personal Property Security Act (2011)	Yes
Philippines	Personal Property Security Act (2018)	Yes
Solomon Islands	Secured Transactions Act (2008)	Yes
Sri Lanka	Secured Transactions Act (2009)	Yes
Thailand	Business Security Act (2015)	Yes

Recently, the World Bank Group and ADB have focused efforts on the deployment of financial inclusion products (falling under a secured transactions law and/or factoring law) designed to boost access to finance for MSMEs operating within supply chains. The World Bank Group, for instance, has highlighted the importance – in the fight to eliminate global poverty – of incentivizing “inclusive and sustainable supply chains.”⁸²

Development programs aimed at creating an enabling legal and regulatory framework for increasing access to finance for MSMEs and other traditionally underserved groups have begun considering banking regulations issued by central banks and other domestic regulatory bodies with increasing frequency. For example, many financial inclusion programs currently aim to reform prudential

⁷⁹ See, e.g., Secured Transactions Law in Asia: Principles, Perspectives and Reform, Edited by Louise Gullifer and Dora Neo (Bloomsbury, 2021), <https://www.bloomsbury.com/us/secured-transactions-law-in-asia-9781509926503/>.

⁸⁰ See also Pacific Financial Inclusion Programme (UN) (“The programme’s objective is to increase the number of low-income Pacific islanders who adopt formal financial services. It achieves this objective by supporting financial service providers to innovate with products and services for mass market customers, supporting governments to create an enabling policy environment for financial innovation, and empowering consumers.”), <https://www.undp.org/pacific/projects/pacific-financial-inclusion-programme>.

⁸¹ See Unlocking Finance for Growth Secured Transactions Reform in Pacific Island Economies (2014), <https://www.adb.org/sites/default/files/publication/42904/unlocking-finance-growth-pacific-island-economies.pdf>.

⁸² See Financing the Future: Incentivizing Inclusive and Sustainable Supply Chains (World Bank Group), <https://live.worldbank.org/events/spring-meetings-2023-supply-chains>.

regulatory regimes, with a specific focus on capital requirements and loan-loss provisioning, to incentivize banks to offer financial inclusion products to customers.⁸³

The World Bank Group has identified AML/CFT rules as a key regulatory issue affecting financial inclusion.⁸⁴ Development programs aimed at implementing revised FATF standards, for example, aim to simplify CDD and AML/CFT requirements in “low-risk” financial products and services (See Sections II-B and II-C for further discussion of CDD).⁸⁵ However, development programs specifically aimed at creating an enabling legal and regulatory framework for increasing access to finance, such as through secured transactions law reform, do not integrate AML/CFT considerations into their design, in the same manner, for example, as prudential regulatory regimes (See Section IV-C, which discusses the importance of coordinating legal frameworks governing individual financial inclusion products with AML/CFT regulations).⁸⁶ This may hinder the rollout of financial inclusion products not covered under existing simplified CDD and AML/CFT requirements.

⁸³ See Coordinating Prudential Regulation and Secured Transactions Frameworks: A Primer (IFC, 2020) (“an assessment of the compliance requirements to launch specific products—for example, supply-chain finance products—might be helpful to identify general gaps and present possible solutions.”), <https://openknowledge.worldbank.org/server/api/core/bitstreams/99d0fd31-d25a-52d9-9187-f16ef6bfe1ec/content>.

⁸⁴ *Id.*

⁸⁵ See Financial Integrity (World Bank Group), <https://www.worldbank.org/en/topic/financialmarketintegrity>.

⁸⁶ Some of these broader perspectives and intersections have been examined by scholars. See, e.g., Giuliano Castellano & Andrea Tosato, Commercial Law Intersections, 72(4) *Hastings L.J.* 999 (2021) (for intersections of various commercial law branches); Giuliano Castellano and Marek Dubovec, Credit Creation: Reconciling Legal and Regulatory Incentives, 81 *Law & Contemp. Probs.* 63 (2018); Giuliano Castellano and Marek Dubovec, Global Regulatory Standards and Secured Transactions Law Reforms: At the Crossroad between Access to Credit and Financial Stability, 41(3) *Fordham Int'l L.J.* 531 (2018); Giuliano Castellano and Marek Dubovec, Bridging the Gap: The Regulatory Dimension of Secured Transactions Law Reforms, 22(4) *Uniform L. Rev.* (2017) (discussing the intersection of secured transactions law and prudential regulation). For the intersection between law and macroeconomics, see Anna Gelpern & Adam J. Levitin, Considering Law and Macroeconomics, 83 *Law & Contemp. Probs.* I. (2020).

IV. Future Work Toward Guidance on De-Banking

The purpose of this Section is to outline options for future work based on the main findings, observations, and recommendations in Sections I-III of this White Paper. The main goal is to develop a guidance document that highlights key issues relevant to de-banking/de-risking for regulatory authorities and financial institutions to design and implement effective risk-based AML/CFT compliance frameworks.

A. KEY FINDINGS AND OBSERVATIONS

The discussions in Sections I-III of this White Paper generated a number of significant findings and observations about the issue of de-banking/de-risking, the most significant of which are summarized in the table below. Addressing these issues requires independent regulators dedicated to financial inclusion that take decisions enhancing the predictability of the governing framework.

Table 9: Key Findings & Observations

Aspect	Findings	Observations
Issues for MSMEs and other traditionally excluded groups meeting Know your Customer requirements	AML/CFT compliance frameworks can impose strict Know Your Customer requirements, including address verification, that many MSMEs and other traditionally excluded groups are unable to meet, causing them to be effectively excluded from the formal financial sector.	Restrictive AML/CFT compliance frameworks not only bar many MSMEs and other traditionally excluded groups from accessing financial services, but also increase the cost of the relevant product/service.
Strategy to address de-banking/de-risking: Risk-Based Approach and Simplified Due Diligence	The main strategy to address de-banking/de-risking is application of the Risk-Based Approach and Simplified Due Diligence, which is generally provided for by law and regulation, but expected to be implemented by banks and other financial institutions.	National regulatory authorities have found it challenging to establish frameworks that effectively recognize the needs of the underserved or excluded.
Application of Risk-Based Approach and Simplified Due Diligence	The application of the Risk-Based Approach and Simplified Due Diligence is typically carried out within the context of programs designed to align domestic AML/CFT frameworks with revised FATF guidance, rather than programs with the specific goal of increasing access to finance among MSMEs and other traditionally excluded groups.	Inadequate attention is paid to application of the Risk-Based Approach and Simplified Due Diligence for purposes of increasing access to finance among MSMEs and other traditionally excluded groups.
Guidance on Risk-Based Approach	The World Bank Group has criticized guidance issued by FATF on the application of the Risk-Based Approach, pointing out in a recent study that it is too general and overly cautious.	Few organizations have issued guidance on the Risk-Based Approach and Simplified Due Diligence other than FATF and (to a much lesser extent) the ADB, IMF, United Nations Office on Drugs and Crime, and the World Bank Group.
National Risk Assessments	States across the Asia-Pacific region have published National Risk Assessments as a way to assist banks and other financial institutions in evaluating the level of ML/FT risk and applying AML/CFT measures accordingly.	Methodologies for evaluating risk are not uniform and few States among the selected Asia-Pacific jurisdictions have incorporated a Financial Inclusion Product Risk Assessment that might incentivize banks and other financial institutions to apply Simplified Due Diligence to potential users of these products.
Financial Inclusion Products Risk Assessment	Those States that have incorporated a Financial Inclusion Products Risk Assessment into their National Risk Assessment may not be adequately identifying what types of products fall within the assessment, including products governed by a secured transactions law.	Ambiguity as to whether a financial inclusion product may be considered low risk (particularly for purposes of Simplified Due Diligence) will not incentivize banks and other financial institutions to offer such products.

Role of Technology	FinTech, and by extension RegTech and SupTech, offer innovative solutions for financial institutions and regulators to address de-banking/de-risking.	RegTech and SupTech can increase accuracy in compliance and lower costs in processes, including simplifying and streamlining fulfillment of Know Your Customer requirements.
RegTech	RegTech has grown into an industry with multiple types of "RegTech vendors" occupying various market segments, including identity verification and management.	The availability of RegTech solutions should be considered when assessing individual country contexts.
SupTech	SupTech is still in early stages of development.	SupTech can provide regulators with greater insight and control over AML/CFT compliance.
Electronic Know Your Customer	Increasingly, banks and other financial institutions are using national ID databases to conduct electronic Know Your Customer, or "e-KYC," instead of reviewing hardcopy documents to verify identification.	In some jurisdictions, such as Pakistan, biometric national identify can be used to open accounts to access financial services.
National Financial Inclusion Strategies	States across the Asia-Pacific region have adopted National Financial Inclusion Strategies that emphasize the importance of the legal and regulatory framework for deployment of various financial inclusion products.	There does not appear to be any National Financial Inclusion Strategies among the select Asia-Pacific jurisdictions that covers the impact of regulatory frameworks for AML/CFT on financial inclusion.
Impact of AML/CFT Regulations on Financial/Credit Infrastructure	In line with National Financial Inclusion Strategies, States across the Asia-Pacific region have spent resources setting up modern financial infrastructure, such as updated secured transactions laws and electronic collateral registries, to boost access to finance for MSMEs and other traditionally excluded groups.	The impact of these investments in financial infrastructure may be undermined by unfavorable AML/CFT regulatory regimes.
Design and Deployment of Financial Inclusion Products	States across the Asia-Pacific region have implemented programs aimed at the design and deployment of specific financial inclusion products, including ones enabled by a modern secured transactions law.	Innovative financial inclusion products will not be utilized by MSMEs and other traditionally excluded groups if they are unable to meet the requirements of the banks or other financial institution's Know Your Customer regime.

B. KEY RECOMMENDATIONS

Consideration of the key findings and observations summarized in the previous Subsection isolates concrete issues and recommendations. Their level of importance is measured from “Low” – meaning less important – to “High” – meaning most important – as reflected in the table below. Identification of the key issues and recommendations will guide discussion about future work considered in the next Subsection.

Table 10: Key Issues & Recommendations

Issue	Recommendation	Priority
Lack of specific guidance on local regulations on how to apply Risk-Based Approach to bank the undeserved.	Review internal AML/CFT compliance frameworks of banks and other financial institutions, assess the degree to which they correspond to international standards, and identify any changes that could be made in order to apply simplified procedures to “low risk” products more frequently.	High
Failure of banks and other financial institutions to apply Risk-Based Approach and Simplified Due Diligence.	Develop guidance on how to incorporate the Risk-Based Approach and Simplified Due Diligence into internal AML/CFT compliance frameworks of banks and other financial institutions as a way to address de-banking/de-risking.	High
Discretionary regulatory frameworks for Simplified Due Diligence may not be effective at incentivizing banks and other financial institutions to apply such procedures in practice.	Identify what regulatory model for Simplified Due Diligence a jurisdiction has established (if any) and determine whether it effectively incentivizes banks and other financial institutions to apply such procedures to their customers in practice.	Medium/High
Current guidance and policy statements on RegTech and SupTech may not adequately consider their potential to, among other, simplify and streamline fulfillment of Know Your Customer requirements, particularly for MSMEs and other underserved groups.	Assess accessibility of RegTech solutions among banks and other financial institutions to simplify and streamline compliance processes, including Know Your Customer and other Customer Due Diligence requirements.	Medium/High
Programs specifically aimed at increasing financial inclusion do not adequately consider the adverse impact of de-banking/de-risking.	Encourage actors working in the area of financial inclusion, including banks and other financial institutions, to consider the issue of de-banking/de-risking and look for opportunities to align AML/CFT frameworks with financial inclusion objectives.	Medium/High
National Financial Inclusion Strategies do not adequately take into account the issue of de-banking/de-risking.	As National Financial Inclusion Strategies are gradually updated, encourage policymakers to emphasize the impact AML/CFT regimes have on financial inclusion and assess whether existing regimes need to be updated to align more closely with financial inclusion objectives.	Low/Medium
Investments in establishing necessary credit infrastructure, such as secured transactions laws and collateral registries, to increase access to finance for MSMEs and other traditionally excluded groups, may be undermined by unfavorable AML/CFT regulatory regimes.	For States in the process of, or currently considering, reforms aimed at establishing necessary credit infrastructure, encourage consideration of whether as part of those reforms the AML/CFT regulatory regime could be modified to more closely align with financial inclusion objectives.	High

C. PROPOSAL FOR FUTURE WORK ON GUIDANCE DOCUMENT ON DE-BANKING/DE-RISKING

A future Guidance Document on De-Banking/De-Risking (hereinafter the "Guidance") could take on one (or a combination) of several forms, which are examined in the following paragraphs.

Audience

The Guidance could target national policymakers and executive agencies overseeing AML/CFT regulations. Regulated entities need to have clear guidance from national regulators about how to implement SDD as well as the circumstances in which alternative identification options may be used for customers for certain groups of customers that struggle to meet minimum identity requirements. Given that many states have yet to establish clear guidance to financial about how apply simplified procedures to "low-risk" products in practice, it would be most suitable to issue guidance addressed to both policymakers and relevant executive agencies as well as private sector banks and financial institutions in these countries. To achieve this, efforts should first be made to implement necessary changes within the FATF and then work closely with regulators to integrate FATF guidance into local regulations. Only then will banks and other financial institutions be able to take effective action.

Geographic focus

The broader geographic focus of the Asia-Pacific region is most appropriate considering the current state of guidance available on de-banking/de-risking. The White Paper has singled out ten States in the Asia-Pacific region and added examples from other jurisdictions where appropriate. A similarly flexible approach is recommended for any future guidance document on de-banking/de-risking.

Subject-matter and purpose

Given the gaps in the current international guidance and standards applicable to de-banking/de-risking, it is advisable to focus the subject matter on AML/CFT compliance frameworks of banks and other financial institutions that effectively apply the Risk-Based Approach and simplified procedures to low-risk (financial inclusion) products. The Guidance should include the following elements:

- Tools for private-sector banks and financial institutions to design cost-effective AML/CFT compliance frameworks through the application of the Risk-Based Approach and Simplified Due Diligence to low-risk financial inclusion products.
- Discussion of how Mutual Evaluations, National Risk Assessments and National Strategies to Address De-Banking can inform private-sector banks and other financial institutions' decision to apply the Risk-Based Approach and simplified procedures to low-risk products.
- Examples of specific financial inclusion initiatives of banks and other financial institutions that take into account AML/CFT compliance regimes.
- A methodological framework for evaluating the effectiveness of a given jurisdiction's AML/CFT regime at incentivizing the application of Risk-Based Approach and Simplified Due Diligence by private-sector banks and other financial institutions, based on revised FATF standards and the three models for risk-based regulatory frameworks discussed in Section II-B.
- Explanation of how authorities and financial institutions can apply RegTech and SupTech solutions, including e-KYC, to simplify and streamline the procedures for setting up (and monitoring) accounts of MSMEs and other traditionally excluded groups.
- Promotion of the idea that fostering the development of RegTech and SupTech, may, through technological innovation, reduce the AML/CFT compliance burdens of private-sector banks

and other financial institutions to open up and manage accounts for MSMEs and other underserved populations.

- Draft example guidance for regulators which could be incorporated into their frameworks to broaden access to products to vulnerable populations that face structural barriers or difficult circumstances that stop them from accessing or obtaining standard identification documents, including: people affected by natural disasters, homelessness, incarceration, modern slavery, domestic violence, refugees, or face discrimination due to gender, sexual orientation or religious beliefs

Methodology

While this White Paper relied primarily on a “desk research” consisting of a review of relevant publicly available standards, guidance and reports, any future guidance document should include practical input from key stakeholders, including (1) standard setters, such as FATF and FATF-Style regional bodies like the Asia-Pacific Group on Money Laundering, (2) international financial institutions, including the ADB and World Bank Group, (3) financial sector regulatory authorities at the national level, such as central banks, (4) private-sector banks and other financial institutions, and (5) representatives from the FinTech industry, including RegTech vendors offering digital identity and verification services.

Although the Guidance should necessarily focus on AML/CFT regulatory regimes, it should also take into account complementary legal frameworks, such as secured transactions legislation and other commercial law frameworks applicable to individual financial inclusion products. This is important for several reasons, including that such frameworks may provide mitigants that should be considered by banks and other financial institutions when determining the ML/FT risk profile of individual financial inclusion products. Consideration of legal frameworks will also aid in uncovering any inconsistencies with AML/CFT regulatory regimes that hinder the uptake of individual financial inclusion products.

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