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Assessing the Financial Action Task Force's Impact on Digital Financial Inclusion

Isabella Chase, Jonathan van der Valk and Tom Keatinge

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Contents

Acronyms

APG – Asia Pacific Group

CDD – customer due diligence

CFATF – Caribbean Financial Action Task Force

EDD – enhanced due diligence

ESAAMLG – Eastern and Southern Africa Anti-Money Laundering Group

FATF – Financial Action Task Force

FinTech – financial technology

FIU – financial intelligence unit

FSRB – FATF-style regional body

ICRG – International Co-operation Review Group

KYC – know your customer

MER – Mutual Evaluation Report

NFIS – National Financial Inclusion Strategy

NRA – National Risk Assessment

RBA – risk-based approach

SDD – simplified due diligence

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Executive Summary

IN MARCH 2021, the Financial Action Task Force (FATF) – the global standard setter for anti-money laundering, counterterrorism financing and counter-proliferation financing controls – established a project to examine the unintended consequences that can stem from the misapplication of its prescribed framework. One of the four unintended consequences it will examine is financial exclusion.[1]

The acknowledgement that poor implementation of the FATF framework can result in financial exclusion is important. Although it was never intended as a vehicle to promote financial inclusion, the FATF has committed to this goal since 2019 via the proportionate implementation of its Standards.[2] Despite this commitment, the evidence discussed in this paper and the establishment of the FATF's project on unintended consequences suggest that implementing the FATF framework to promote financial inclusion is not a simple task.

In practice, financial exclusion stemming from the implementation of the FATF framework is just one of the many barriers that keep 1.7 billion people around the world out of the formal financial system.[3] Those who already contend with physical, educational and cultural barriers to accessing finance can struggle the most to meet the financial crime requirements that stem from the FATF system. Digital financial services, such as mobile money and FinTech, have made it easier for many people around the globe to overcome hurdles to accessing finance. However, adoption of digital financial services can still be hamstrung by a poor understanding and implementation of the FATF framework by countries, their financial regulators and financial services providers.

This paper aims to complement the work of the FATF's project on unintended consequences and assess the extent to which the FATF framework has impacted digital financial inclusion. It considers each stage of the FATF process, determining to what degree they have impacted digital financial inclusion.[4]

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1. For further details on the Financial Action Task Force's (FATF) project on unintended consequences, see FATF, 'Mitigating the Unintended Consequences of the FATF Standards', <http://www.fatf-gafi.org/publications/financialinclusionandnpoissues/documents/unintended-consequences-project.html>, accessed 3 May 2021.
2. FATF, 'FATF Ministers Give FATF an Open-Ended Mandate', 12 April 2019, <https://www.fatf-gafi.org/publications/fatfgeneral/documents/fatf-mandate.html#:~:text=Washington%2C%20D.C.%2C%2012%20April%202019,of%20weapons%20of%20mass%20destruction>, accessed 30 March 2021.
3. Asli Demirgüç-Kunt et al., *The Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution* (Washington, DC: World Bank, 2018).
4. This paper reflects on the impacts that the FATF has had on digital financial inclusion and financial inclusion more generally. It is complemented by a Policy Brief which sets out five policy

This paper's findings are based on an extensive literature review and 90 interviews held virtually throughout 2020 with a range of stakeholders from the public, private and third sectors, with expertise spanning across financial crime controls, financial inclusion and international development. In addition to engaging with international experts, three countries – Tanzania, Pakistan and Indonesia – were selected as case studies to better understand how the FATF framework can impact digital financial inclusion on the ground.

This paper finds that the FATF framework has several effects on digital financial inclusion and financial inclusion more generally. Occurring at different stages of the FATF process, they can be summarised as follows:

- **The FATF Standards**. The FATF Standards afford the necessary provisions and flexibility to support financial inclusion. However, this paper finds that despite the requisite tools being in place, there are insufficient incentives within the framework to ensure they are implemented in a way that supports inclusion. When entities do take advantage of these tools, the impact is impeded by limited guidance on how to implement them.
- **The Mutual Evaluation Report (MER) process**. In theory, much like the FATF Standards, the MER process should not adversely impact financial inclusion. In practice, while the process has not directly harmed inclusion, it has indirectly inhibited it by failing to bolster the narrative that financial inclusion and the robust implementation of financial crime controls are mutually beneficial. Inconsistent treatment of financial inclusion in the MER process is worsened by the limited training assessors receive on the subject.
- **FATF listing procedures**. This paper supports previous studies that have found FATF listings have several impacts on financial inclusion.[5] It upholds findings that the FATF impacts correspondent banking relationships, but also points to the significant repercussions for listed countries on national policymakers, the investment climate and remittances. It contends that better data is needed to validate these impacts.
- **The FATF governance structure**. The role that the FATF presidency and wider governance structure plays in positioning financial inclusion within the FATF framework is often overlooked. The president, FATF and FSRB secretariats and other associated international bodies, such as the World Bank, play a vital role in setting the tone for how the FATF framework should be complied with. They must do more to ensure that all stakeholders understand that proper implementation of the FATF framework benefits financial inclusion and, as a result, a country's financial integrity.

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recommendations for how the FATF could do more to promote financial inclusion. See Isabella Chase and Tom Keatinge, 'Walk the Talk: How the Financial Action Task Force Can Prioritise Financial Inclusion', RUSI Policy Brief, June 2021.

5. Tracey Durner and Liat Shetret, 'Understanding Bank De-Risking and its Effects on Financial Inclusion: An Exploratory Study', Research Report, Global Center on Cooperative Security, November 2015, <https://oxfamilibrary.openrepository.com/bitstream/handle/10546/582310/rr-bank-derisking-181115-en.pdf?sequence=4&isAllowed=y>, accessed 30 March 2021.

In sum, this paper finds that the FATF framework could be used to better support financial inclusion. However, without appropriate recognition, committed action and proper incentives to do so, financial inclusion will continue to be overlooked.

Introduction

THE FINANCIAL ACTION Task Force (FATF) is the international standard setter for combating money laundering, terrorist financing and proliferation finance. Its framework, which includes the FATF Standards, mutual evaluations, listing procedures and member state-led governance, has created a system that stretches across the globe and applies to all formal financial transactions that take place within it. Born out of efforts to control the illegal drugs trade in 1989 and accelerated by the response to 9/11, the FATF's mission has primarily focused on curtailing financial crime risk and the human harms associated with it.

Despite this admirable focus, the system has been criticised for creating unintended consequences.[1] In March 2021, the FATF launched a project to study and mitigate those that can result from the incorrect implementation of its framework.[2] One of the four unintended consequences that this project will examine is financial exclusion – the phenomenon whereby individuals are denied access to and use of formal financial services such as bank or mobile money accounts.

The FATF framework, although not designed with financial inclusion in mind, has included provisions that protect inclusion since its inception.[3] As it has evolved, the FATF has acknowledged that financial inclusion complements its primary objective of tackling financial crime. In 2019, when the group drew up its own permanent mandate, it stated: 'The FATF will continue to promote financial inclusion and encourage proportionate and effective implementation of the FATF Standards by countries in line with the risk-based approach'.[4]

The FATF's interest in promoting financial inclusion is not surprising. In fact, financial inclusion is a key enabler of the success of the FATF framework. For the FATF to effectively combat illicit finance, everyone must be able to access and use formal financial services and choose to do so over informal channels. Informal financial services are outside the purview of the FATF and offer an ecosystem in which illicit finance can flourish, unrestrained by the controls that the FATF

1. Louis de Koker, 'Money Laundering Control and Suppression of Financing of Terrorism: Some Thoughts on the Impact of Customer Due Diligence Measures on Financial Exclusion', *Journal of Financial Crime* (Vol. 13, No. 1, 2006).
2. For further details on the Financial Action Task Force's (FATF) project on unintended consequences, see FATF, 'Mitigating the Unintended Consequences of the FATF Standards', <http://www.fatf-gafi.org/publications/financialinclusionandnpoissues/documents/unintended-consequences-project.html>, accessed 3 May 2021.
3. Authors' virtual interview with academic E, 3 June 2020.
4. FATF, 'FATF Ministers Give FATF an Open-Ended Mandate', 12 April 2019, <https://www.fatf-gafi.org/publications/fatfgeneral/documents/fatf-mandate.html#:~:text=Washington%2C%20D.C.%2C%2012%20April%202019,of%20weapons%20of%20mass%20destruction>, accessed 30 March 2021.

recommends. The recognition that financial inclusion strengthens the reach of financial crime controls, and thus the overall integrity of the economy, is known as inclusive financial integrity.[5]

However, inclusive financial integrity can be hamstrung by the very system that aims to strengthen it. Financial crime controls, the standards for which are set by the FATF, have been shown to create barriers to finance and exclude segments of the population who cannot meet the necessary requirements.[6] The cost of performing financial crime checks in line with the FATF Standards can be too great for service providers to offer products to lower-value customers. In addition, these customers might not have access to the required identity documentation, which creates further challenges to inclusion.[7] The FATF framework contains provisions to guard against financial exclusion in scenarios that have been deemed as low risk. However, despite these provisions, the establishment of the project on unintended consequences indicates that the FATF is aware that financial exclusion related to its controls still occurs.

The FATF's renewed focus on financial exclusion comes at an important moment. The coronavirus pandemic has emphasised the importance of ensuring populations are financially included and able to access finance and fiscal support via traditional and digital channels. It also comes as the FATF pursues a once-in-a-generation strategic review, which will evaluate its practices and whether they are fit for purpose.[8]

To better understand how the incorrect implementation of the FATF regime can result in financial exclusion, this paper examines how the different elements of the FATF framework have impacted financial inclusion.

Scope

This paper considers the impact of the FATF regime on financial inclusion from the perspective of national authorities responsible for compliance with the FATF regime as well as national authorities responsible for financial inclusion. In addition, it examines the challenges faced by digital financial services providers who offer products designed to serve individuals currently

5. Alliance for Financial Inclusion (AFI), 'Inclusive Financial Integrity: A Toolkit for Policymakers', 14 July 2020, <https://www.afi-global.org/publications/inclusive-financial-integrity-a-toolkit-for-policymakers/>, accessed 3 May 2021.
6. Alan Gelb and Diego Castrillon, 'Identifying and Verifying Customers: When are KYC Requirements Likely to Become Constraints on Financial Inclusion?', Working Paper No. 552, Center for Global Development, December 2019.
7. Citi GPS: Global Perspectives and Solutions, 'Banking the Next Billion: Digital Financial Inclusion in Action', January 2020.
8. In 2019, the FATF announced that it would carry out a strategic review of how its evaluations can better promote and enable more effective and efficient anti-money-laundering/counterterrorism-financing (AML/CTF) controls. For more details, see David Lewis, 'Remarks at the RUSI Meeting on the Financial Action Task Force Strategic Review', FATF, 8 November 2019, <https://www.fatf-gafi.org/publications/fatfgeneral/documents/rusi-fatf-strategic-review.html>, accessed 25 March 2021.

excluded from the formal financial system. This has been selected as a focus because most of the 1.7 billion people without access to a bank or mobile money account live in the Global South,[9] where digital financial services are leapfrogging traditional financial service providers to be the main point of access to the formal financial system – this is commonly referred to as digital financial inclusion. For the purpose of this paper, 'disadvantaged groups' refers to those who currently have no access to a financial account.

This paper is complemented by a Policy Brief, which makes policy recommendations for how the FATF can more actively promote financial inclusion in the future.[10]

Methodology

The research for this paper was informed by a literature review and semi-structured interviews. The literature review, conducted between February and May 2020, was both expansive, covering the general literature on the topic, and targeted, focusing on Tanzania, Pakistan and Indonesia. It surveyed available English-language academic and grey literature published on this topic since 2008, analysed relevant FATF documents, and examined reports and documents published by other international organisations.

To supplement the general literature and extremely limited data on this topic, three case study countries – Tanzania, Pakistan and Indonesia – were selected to gain a greater understanding of how the impacts of the FATF framework can be felt on the ground. They were selected using two criteria. First, they are priority countries for the Bill and Melinda Gates Foundation's Financial Services for the Poor programme, which focuses on countries where the provision of digital financial services is likely to have the greatest impact on alleviating poverty for disadvantaged groups. Second, these countries have either recently undergone a mutual evaluation by the FATF or a FATF-style regional body (FSRB), are currently undergoing one or have had theirs postponed due to the coronavirus pandemic.

Building on the literature review and a virtual workshop with financial inclusion academics,[11] the research team conducted 90 semi-structured interviews with experts in the case study countries and across the globe. Interviewees were selected from the public, private and third sectors based on their expertise in financial inclusion and/or financial crime compliance. In each case study country, the research team tried to speak to the public authorities responsible for anti-money laundering/counterterrorism financing (AML/CTF), including the financial intelligence unit (FIU), as well as those responsible for financial inclusion initiatives. In the private sector, in-country interviewees were from traditional and digital financial services operating domestically

9. Demirgüç-Kunt et al., *The Global Findex Database 2017*, p. 4.
10. Isabella Chase and Tom Keatinge, 'Walk the Talk: How the Financial Action Task Force Can Prioritise Financial Inclusion', RUSI Policy Brief, June 2021.
11. The virtual workshop was held with UK and EU academics who work on financial inclusion matters. It aimed to scope the academic work in this field and identify areas in which greater research is needed.

and internationally which aim to serve unbanked populations. In the third sector, the research team spoke to experts from NGOs and academics.

The research team carried out 22, 21 and 19 in-country interviews in Tanzania, Pakistan and Indonesia, respectively. These all took place virtually and had a semi-structured format. The research team took the same approach to fieldwork in each country, reaching out to similar groups for interviews and asking comparable questions. The remaining 28 interviews were held with financial inclusion and financial crime compliance experts based outside the case study countries. Profiles were composed for each case study country, based on the findings.[12]

Several challenges arose during the research process. Four months into the project, the coronavirus pandemic forced most of the world into lockdown. The research team and all engagement for the project pivoted to online working. The impact of the pandemic on the research is unclear, but the research team was nonetheless able to engage with a wide pool of experts. For the virtual fieldwork, the team were limited to UK office hours, narrowing the window of opportunity for holding interviews internationally. The range of experts that could be engaged with was limited by the fact that all interviews were held in English. Furthermore, all case study countries have recently undergone or are preparing for a mutual evaluation or are subject to increased FATF monitoring – in some cases, this increased sensitivity around the topics discussed. Moreover, in Tanzania, a general election was held on 28 October 2020 which exacerbated some interviewees' hesitancy to engage with external researchers.

The quantitative data for this topic area is extremely limited and, in places, virtually non-existent. As such, the research team has relied almost entirely on findings gathered during interviews and the literature review. Given this limitation, this paper's findings are of most relevance to the case study countries. However, they can be extrapolated to the wider implementation of the FATF framework due to the international experts that were also consulted.

Definitions

The terms 'financial inclusion' and 'digital financial inclusion' have multiple definitions. For the purpose of this paper, the following definitions are used.

- **Financial inclusion**. This paper uses the FATF definition of financial inclusion, which states that 'financial inclusion involves providing access to an adequate range of safe, convenient and affordable financial services to disadvantaged and other vulnerable groups, including low income, rural and undocumented persons, who have been underserved or excluded from the formal financial sector'.[13]

12. Shortened versions of these profiles can be found in the Appendix, and tables have been included throughout the paper to share specific findings from each case study country.
13. FATF, 'Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion: With a Supplement on Customer Due Diligence', November 2017, pp. 22, 38.

- **Digital financial inclusion**. The paper also uses the FATF definition for digital financial inclusion: the 'use of digital financial products and services to advance financial inclusion. It involves the deployment of digital means to reach financially excluded and underserved populations with a range of regulated financial services tailored to their needs, delivered responsibly at a cost affordable to customers and sustainable for providers'.[14]

These definitions have been selected to ensure that this paper's findings are as relevant as possible to the FATF framework and its understanding of financial inclusion.

The above definitions are contested.[15] The more prevailing definition of financial inclusion in this space goes beyond just access to financial services to include the *use* of financial services by underserved populations.[16] By not incorporating use, the FATF's definitions do not cover the whole landscape of financial inclusion. For this reason, statistics on digital financial inclusion can be misleading, accounting only for access to products and services and not the extent to which they are actually used. For the purposes of this study, statistics from the World Bank's Global Findex Database were applied. These incorporate both access and use of digital financial services.[17]

The 'use of digital products and services' was taken to include the main digital products and services used in the case study countries for financial inclusion. These included: mobile money; mobile payment platforms; digital saving platforms and groups; digital identification verification solutions; and the use of digital IDs. The use of virtual assets was not considered as part of this research as they have not been used to a significant extent for financial inclusion in the case study countries. This study also did not consider unregulated digital financial services, as these fall outside the FATF regime.

Structure

This paper is comprised of five chapters. Chapter I explains the benefits that digital financial inclusion can bring to the unbanked, looks at the hurdles that prevent the use of digital channels for financial inclusion, and introduces financial crime controls as a barrier to financial inclusion. The following four chapters analyse the different elements of the FATF framework – its Standards, the mutual evaluation process, the listing procedures and its governance structure – to determine what impact, if any, these have had on digital financial inclusion in the case study countries and on financial inclusion more broadly. The paper concludes with an assessment of what this research can reveal about the overall impact of the FATF regime on financial inclusion.

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14. *Ibid.*, p. 22.
15. *Ibid.*, p. 38.
16. Kate Lauer and Timothy Lyman, 'Digital Financial Inclusion: Implications for Customers, Regulators, Supervisors, and Standard-Setting Bodies', CGAP Brief, February 2015, <https://www.cgap.org/sites/default/files/researches/documents/Brief-Digital-Financial-Inclusion-Feb-2015.pdf>, accessed 30 March 2021.
17. Demirgüç-Kunt et al., *The Global Findex Database 2017*.

I. What Is Digital Financial Inclusion?

TO UNDERSTAND THE impact of the FATF and its controls on digital financial inclusion, it is first important to understand the benefits of digital financial inclusion for those who have no access to formal finance and the context of the other barriers to access they face.

Around the world, roughly 1.7 billion people have no access to formal finance.[18] These tend to be the poorest people in the world. Two-thirds report not having enough money as the primary barrier to account ownership followed by individuals not wanting to having one.[19] Against this background, this research is concerned with disadvantaged groups who do want access to formal financial services and have enough money to achieve this but cannot do so because they are constrained by several factors – one of which may be the FATF regime.

Benefits of Digital Financial Inclusion

The benefits of financial inclusion for disadvantaged groups can be substantial. At a macro level, financial inclusion contributes to eight of the UN's Sustainable Development Goals.[20] It can also help individuals out of poverty and enable them to seek greater empowerment in their lives.[21]

For disadvantaged groups seeking access to formal finance, digital tools can offer particularly attractive means of doing so. In the Global South (where most unbanked individuals live), digital financial service providers such as mobile money operators (MMOs) have 'leapfrogged' traditional financial services by offering more affordable products that do not rely on expensive and often hard-to-reach 'brick and mortar' bank branches. In addition to basic transaction accounts, digital financial services tend to offer a greater a range of products targeted at lower-income groups such as micro loans and credit which can help to further empower disadvantaged groups.

The coronavirus pandemic has highlighted digital finance as an essential tool for coping with emergencies and economic shocks. Globally, digital financial products have been increasingly embraced to mitigate the restrictions and challenges of the pandemic and its public response.[22] UN Women estimates that in 2021, at least 47 million more women and girls will fall below the

18. *Ibid.*
19. *Ibid.*
20. UN Capital Development Fund, 'Financial Inclusion and the SDGs', <https://www.uncdf.org/financial-inclusion-and-the-sdgs>, accessed 3 May 2021.
21. Authors' virtual interview with academic H, 22 September 2020.
22. Niclas Benni, *Digital Finance and Inclusion in the Time of COVID-19: Lessons, Experiences and Proposals* (Rome: Food and Agriculture Organization of the UN, 2021), p. 7.

poverty line, and the UN Capital Development Fund has advocated for governments and businesses to prioritise digital financial inclusion in order to build back stronger following the pandemic.[23]

Challenges to Digital Financial Inclusion

Ensuring that disadvantaged groups have access to digital financial services is not without its challenges. This paper groups common foundational challenges to digital financial inclusion into the following categories: physical infrastructure; cultural norms; and knowledge. However, these three categories only go so far in conveying the plethora of challenges faced by these groups. It is also important to consider the challenges faced by the providers of digital financial services alongside those faced by consumers.

Physical infrastructure is a key impediment to digital financial inclusion. To power inclusion, consumers must have access to reliable electricity and the internet. When establishing new products, developed agent networks are essential to spread services across a country. This spread can be further constrained by the geography of a country, as is the case in Indonesia, which is made up of over 17,000 islands. This can create significant challenges for connectivity.[24]

Once the physical infrastructure is in place to support digital financial services, consumers must have the knowledge to access and use them. Disadvantaged groups tend to have a lower level of education and can therefore lack the digital or financial literacy needed to make use of digital financial services – this can be exacerbated in rural areas where levels of education can be further reduced.[25]

Cultural norms can also present powerful barriers to inclusion. Digital financial exclusion may be voluntary, the result of an unwillingness to use digital tools or deal with banks because of religious, cultural or lifestyle decisions.[26] In addition, cultural norms regarding gender can shape a perception that women should not be involved in finance. In rural areas of Tanzania and Pakistan, for example, interviewees reported that it was not uncommon for there to be a perception that finance 'is not for women'.[27] Women may also not be allowed to own mobile phones or register a phone in their own name, which further prevents their access to digital financial services.[28]

23. Ginette Azcona et al., *From Insights to Action: Gender Equality in the Wake of COVID-19* (New York, NY: UN Women, 2020), p. 7.
24. Authors' virtual interview with academic H, 22 September 2020.
25. Demirgüç-Kunt et al., *The Global Findex Database 2017*.
26. Peterson K Ozili, 'Impact of Digital Finance on Financial Inclusion and Stability', *Borsa Istanbul Review* (Vol. 18, No. 4, 2018), pp. 329–40.
27. Authors' virtual interview with FinTech F, 29 September 2020; authors' virtual interview with FinTech H, 21 October 2020.
28. *Ibid.*

Challenges faced by digital financial service providers should also be considered. FinTechs and other providers can face sizeable market entry barriers stemming from regulatory environments designed with traditional financial services in mind. Unable to keep pace with the potential and real hazards of new innovations, including fraud, data privacy violations and cybercrime, there may be 'regulatory overactions that stifle innovation'[29] or regulatory inaction which hinders access.[30]

Financial Crime Controls as a Challenge to Digital Financial Inclusion

Alongside the ongoing challenge presented by physical, cultural, knowledge-based and market entry barriers, financial crime controls are a commonly cited impediment to digital financial inclusion.[31]

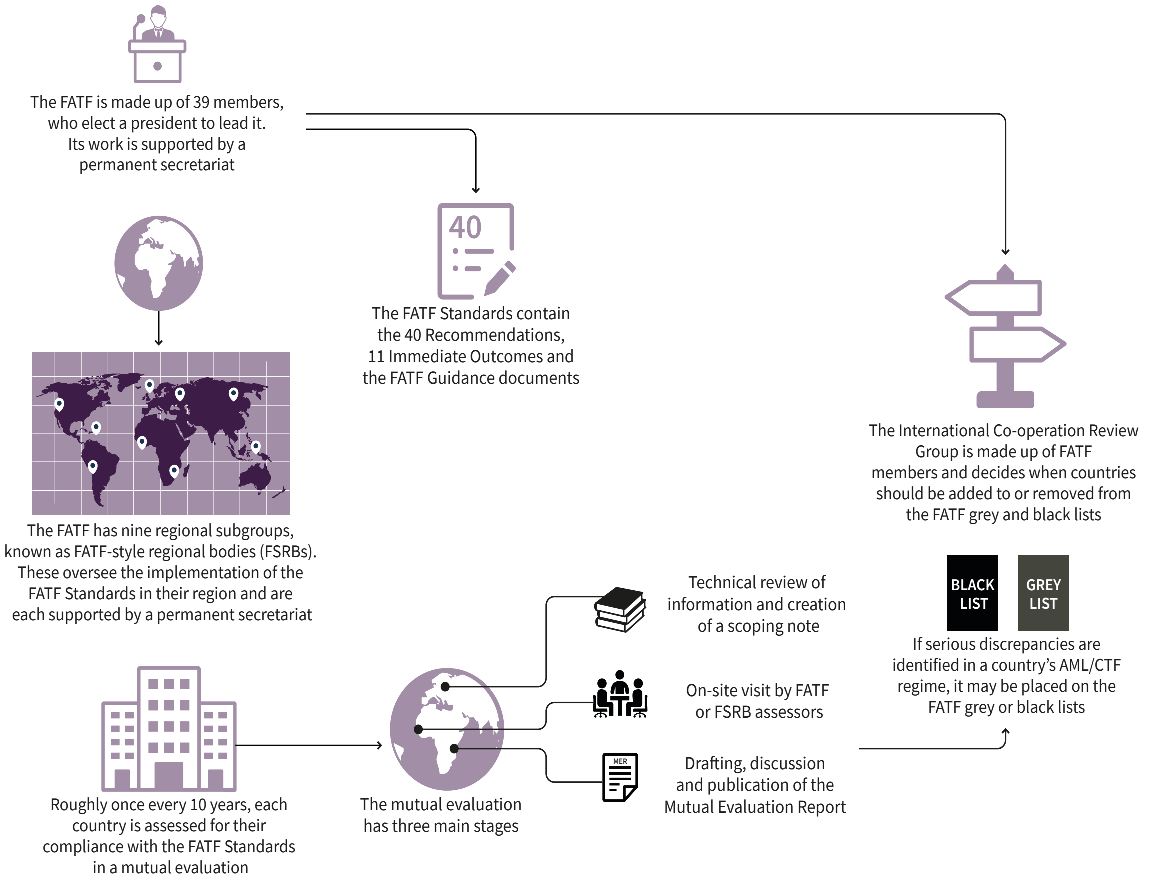
Financial crime controls materialise for both consumers and digital financial service providers as checks performed when new financial accounts are opened. They are designed to ensure that the customer is who they say they are and that they do not pose a level of financial crime risk exceeding the risk appetite of the financial service provider. If an account is established, checks should be performed on an ongoing basis to ensure that the risk of the client remains palatable. If the risk exceeds the appetite of the financial service provider they can choose to deny the customer access to their services and, as a result, finance. Moreover, the cost of carrying out checks in the first place may outweigh the value of the customer and thus deter the service provider from offering services to them.

For those who cannot access formal financial services because they do not meet the requirements of financial crime controls or are not of high enough value to warrant checks in the first place, informal financial services may be the only avenue to obtain finance. This unregulated market not only lacks transparency and oversight, thus allowing illicit finance to flourish, but also makes users more vulnerable and susceptible to becoming victims of crime themselves.[32]

The process described above explains financial crime checks at their most basic level. The details on how these controls should be performed in practice are set by the FATF. To better understand why financial crime controls can induce financial exclusion, this paper dissects each element of the FATF framework, evaluating the experience of the three case study countries to better understand how this process has impacted digital financial inclusion and what this could indicate about the system at large. A summary of the FATF framework and its key elements is illustrated in Figure 1.

29. UN Secretary General's Special Advocate for Inclusive Finance for Development FinTech Working Group and CCAF, 'Early Lessons on Regulatory Innovations to Enable Inclusive FinTech: Innovation Offices, Regulatory Sandboxes and RegTech', 2019, <https://www.jbs.cam.ac.uk/wp-content/uploads/2020/08/2019-early-lessons-regulatory-innovations-enable-inclusive-FinTech.pdf>, accessed 31 March 2021.
30. *Ibid.*
31. Gelb and Castrillon, 'Identifying and Verifying Customers'.
32. Authors' virtual interview with international organisation J, 27 October 2020.

Figure 1: Simplified FATF Framework



Source: Author generated; FATF, 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations', updated October 2020.

II. The FATF Framework: FATF Standards

TO ASSESS THE impact that the FATF's framework has on digital financial inclusion, its elements – the Standards, the mutual evaluation process, the listings procedure and its governance – must be examined in turn. This chapter considers the FATF Standards.

Based on a set of 40 Recommendations, the FATF Standards inform a country's AML/CTF framework.[33] These Recommendations are supplemented by a set of interpretive notes providing added detail on implementation. The FATF also produces additional guidance documents on an ad hoc basis. These allow it to respond to the evolving environment in which its framework exists, for example by detailing how regulated entities should navigate new technologies in their work.[34] Together, the Recommendations, interpretive notes and guidance documents make up the FATF Standards.[35]

In 2012, the FATF revised the 40 Recommendations and interpretive notes to place heavier emphasis on the risk-based approach (RBA). The RBA replaced a more rigid, rules-based approach and provides flexibility to the FATF Standards, allowing for their proportional application in line with the level of financial crime risk identified. This chapter highlights where the FATF Standards, though well intentioned, can stifle financial inclusion.

Impact of the RBA and FATF Recommendations on Digital Financial Inclusion

Recommendations 1 and 10 are integral to the FATF's impact on digital financial inclusion. Recommendation 1 sets the standard for assessing risk and applying the RBA and creates the provision that, in lower-risk scenarios, simplified measures can be used. Recommendation 10 creates the requirement for customer due diligence (CDD), which ensures that regulated entities know who they are dealing with and that formal financial accounts cannot be anonymously owned. The interpretive note on Recommendation 10 sets out how CDD can be simplified in low-risk scenarios to simplified due diligence (SDD).

33. FATF, 'The FATF Recommendations', updated October 2020, <http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html>, accessed 30 March 2021.
34. For FATF guidance documents that are available as of 30 March 2021, see FATF, 'All Publications', <http://www.fatf-gafi.org/publications/?hf=10&b=0&r=%2Bf%2Ffatf_documenttype_en%2Fguidance&s=desc(fatf_releasedate)>, accessed 30 March 2021.
35. The FATF Standards are enhanced by 11 Immediate Outcomes which assess the overall effectiveness of a country's AML/CTF regime. These are assessed during a country's mutual evaluation and are discussed in more detail in Chapter III.

When considered together, these Recommendations should facilitate financial inclusion by allowing for the use of SDD when low financial crime risk is identified. SDD is beneficial for financial inclusion, as checks can be less resource intensive, making them cheaper to perform, and easier for disadvantaged groups to pass. However, for these benefits to be felt, the RBA and SDD must be implemented correctly, and evidence shows that this can be constrained by several factors.

First, to be able to use SDD, it is essential to have an adequate grasp of the financial crime risks in a country. By the FATF's own measure, only 36% of assessed countries have a high or substantial understanding of their financial crime risk and a corresponding response to it.[36] A country's understanding of its risk relies on its National Money Laundering and Terrorist Financing Risk Assessment (NRA), but carrying out an NRA is a significant undertaking and is rarely adequately conducted.[37] Lower-capacity countries, in particular, can struggle to carry out an adequate risk assessment and may hire external consultants to help them do so. Consultants may lack the local knowledge necessary to devise an assessment that both reflects the risks and takes account of the local financial inclusion landscape.[38] In addition to using consultants, there are other tools available to countries to help them perform their NRA, such as those provided by the IMF and the World Bank.[39] However, although useful, it was reported that these can be difficult to use and may not fit with a country's context.[40]

The NRA is key to the successful implementation of the RBA as it identifies where risk is low, medium or high, and where controls can be simplified or must be elevated. To operationalise the findings of the NRA and inform the RBA, the NRA must be shared with regulated entities in a timely fashion. However, this is not always guaranteed – for example, Tanzania conducted its NRA in 2016 but did not make it public until 2019, and Pakistan is yet to make its 2017 NRA public, although it was updated in 2019.[41]

Without a strong understanding of risk, it is unlikely that the RBA will be implemented in a way that can facilitate the use of SDD. As demonstrated by Table 1, out of the case study countries,

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36. FATF, 'Consolidated Assessment Ratings', <https://www.fatf-gafi.org/publications/mutualevaluations/documents/assessment-ratings.html#:~:text=Through%20its%20nine%20FATF%2DStyle,to%20implementing%20the%20FATF%20Recommendations>, accessed 16 May 2021.
37. Authors' virtual interview with international organisation K, 3 December 2020.
38. *Ibid.*
39. IMF, 'The International Monetary Staffs' ML/FT NRA Methodology', <http://www.fatf-gafi.org/media/fatf/documents/reports/Risk_Assessment_IMF.pdf>, accessed 7 June 2021; World Bank, 'Risk Assessment Support for Money Laundering/Terrorist Financing', 29 February 2016, <https://www.worldbank.org/en/topic/financialsector/brief/antimoney-laundering-and-combating-the-financing-of-terrorism-risk-assessment-support>, accessed 27 May 2021.
40. Authors' virtual interview with public sector body A, 7 May 2020.
41. United Republic of Tanzania, Ministry of Finance and Planning, 'National Money Laundering and Terrorist Financing Risk Assessment Report', December 2016, <https://www.fiu.go.tz/TanzaniaNRA(Main)ReportDec2016.pdf>, accessed 30 March 2021.

Indonesia has achieved a substantial level of effectiveness in considering risk and applying the RBA. In all three countries, interviewees reported concerns with the application of the RBA and stressed an uneven application across the regulated sectors and the extent to which the RBA reflected the financial crime risk in the country.[42]

Table 1: Implementation of the RBA in Case Study Countries

	Tanzania	**Pakistan**	**Indonesia**
Is the RBA enshrined in law?	Yes	Yes	Yes
Compliance with Immediate Outcome 1	Awaiting rating	Low level of effectiveness	Substantial level of effectiveness
How did interviewees perceive the RBA in practice?	The use of the RBA appears to be uneven across the regulated sector, which is reflected in the level of understanding of the financial crime risk. The RBA is well understood and implemented among international organisations operating in Tanzania – specifically international banks and MMOs. Although well-intentioned, regulators have limited resources, with the RBA sometimes being misinterpreted. Interviewees felt the country's most recent NRA was overly conservative in its application of risk rating, with several perceived as higher than necessary.	The RBA is still maturing, and although the concept is embedded in regulation, entities are not confident in its use. This is especially true for the designated non-financial business and professions (DNFBP) sector where the use of an RBA is rare. Regulators have become more risk averse since the 2018 FATF greylisting and are hesitant to employ the RBA. More inclusive approaches to compliance have been paused until reforms triggered by the FATF action plan have been integrated into compliance polices and procedures.	The RBA is quite mature, with a broad understanding across compliance professionals in both traditional and digital financial service providers. However, regulators are not comfortable in allowing the wide-scale use of SDD. Interviewees expressed a desire for greater clarity on its use.

Source: Authors' interviews.

To prevent shortcomings in the implementation of the RBA, it is essential that national supervisors have the capacity and confidence to supervise its implementation by regulated entities. To do so in such a way that supports digital financial inclusion, they must be fluent

42. Interviews held throughout the research project.

in the risks and demands of digital financial services and be able to guide providers in safely simplifying controls where risk is identified to be low to enable financial inclusion. However, supervisors can struggle to keep pace with digital financial service providers and their latest offerings, resulting in supervisory practices which are unfit for these business models.[43] In Indonesia, for example, supervision of the FinTech sector has been delegated to the FinTech trade body AFTECH instead of remaining with the financial and payment regulators, as it is felt that AFTECH has better knowledge of the sector.[44]

Furthermore, supervisors may lack the confidence to authorise the use of SDD. As with the wider implementation of the RBA, lower-capacity countries can lack the know-how necessary to implement the nuances within the FATF framework. Countries may not want to 'go first' for fear of being perceived to have 'gotten it wrong' in their Mutual Evaluation Report (MER).[45] This fear is well founded. A recent study by the World Bank found that, after reviewing 107 MERs, it is more common for the use of SDD to be criticised by the MER than praised. The study noted that this criticism is mostly due to countries failing to demonstrate the RBA and justify the use of SDD.[46]

The lack of praise for implementing SDD reveals a larger constraint on its use – the lack of incentive to do so. Unlike the provision of enhanced due diligence (EDD) that must be applied when high risk levels are identified, the use of SDD in low-risk scenarios is optional.[47] The optional nature of the SDD means that it is rarely used to its fullest extent. If resources are limited, developing the skills and policies necessary to effectively use SDD is outweighed by the obligatory requirement of ensuring that CDD and EDD procedures are in place. The latter should be the priority of regulated entities, but the negative implications for inclusive financial integrity if SDD cannot be used in low-risk scenarios must be noted in countries' overall effectiveness and, ultimately, in the FATF Standards themselves.

For regulated entities to have the confidence to use SDD, further clarity on how it should be implemented is required. When comparing the level of detail provided on EDD and SDD in the interpretive note to Recommendation 10, much greater clarity is given on the use of EDD. The lack of clarity on SDD increases the window for misinterpretation of this provision. For example, it is not uncommon for entities to think that the presence of any risk rules out the use of SDD.[48] There are, of course, very few – if any – products that have no financial crime risk so this interpretation can be detrimental for financial inclusion.

43. Authors' virtual interview with FinTech C, 14 May 2020.
44. Authors' virtual interview with private sector body C, 29 October 2020.
45. Authors' virtual interview with NGO C, 18 March 2020.
46. Kuntay Çelik and Valéria Salomão Garcia, 'Unintended Consequences of the Global Standards on Financial Inclusion', World Bank, draft, April 2021.
47. FATF, 'The FATF Recommendations'.
48. Authors' virtual interview with financial institution A, 24 June 2020.

Table 2: Reported Use of SDD in Case Study Countries

	Tanzania	Pakistan	Indonesia
Use of SDD as described in the most recent MER	Publication of most recent MER still awaited.	The 2019 MER details how several banks and micro-finance banks (MFBs) have adopted SDD measures as part of a tiered know-your-customer (KYC) approach for low-risk bank accounts, including the Asaan52 accounts. In these instances, risk-mitigation measures – transaction and monthly debit turnover limits – have been enacted. MFBs are permitted to open micro-savings accounts with SDD, provided the accounts are low risk or low balance and if there is no doubt regarding the identity of the account holder.	The country's 2018 MER notes that some banks have introduced savings accounts for financial inclusion using SDD, putting in place risk-mitigation measures such as maximum transaction amounts. Banks use digital ID (electronic knowledge transfer partnerships; eKTP) to perform KYC checks, but also implement SDD measures for customers without eKTP alongside risk-mitigation measures.
Interviewees' perception of the use of SDD	Tightening AML/CTF regulations appear to be making it more difficult to use SDD. Before the introduction of the digital ID scheme, MMOs were able to accept other simple forms of ID for lower-risk customers, allowing them to use SDD. There is concern that the new ID scheme removes this ability. In addition, small savings groups are experiencing higher levels of due diligence as new regulations are introduced.	The 'Branchless Banking' scheme is used to promote financial inclusion. It provides two tiers for low-risk customers where the National Database & Registration Authority (NADRA) ID scheme can be used to open accounts. The higher-tier, low-risk account requires biometric verification which some interviewees perceived as restrictive as it requires biometric verification machines to be able to use services. Account limits designed to curtail risk can create barriers to use – if transaction limits are exceeded, users can face blocks on their accounts.	SDD is currently part of the regulatory framework. Its use is limited to government services run via state-owned banks and basic e-money accounts. Private sector interviewees expressed the view that if it was permissible and if there was more guidance they would use SDD more often to foster financial inclusion.

Source: Authors' interviews.

How Do the FATF Guidance Documents Treat Financial Inclusion?

The FATF Standards are supplemented by a set of guidance documents, which offer additional details on how to implement the FATF Standards in specific circumstances. Of note for digital financial inclusion is the guidance document on AML/CTF measures and financial inclusion, which includes a supplement on CDD and the guidance on an RBA to prepaid cards, mobile payments and internet-based payment services.[49]

Some commentators have argued that the presence of a guidance document on financial inclusion illustrates that the FATF Standards do not go far enough to support this topic.[50] However, to others, the guide is broadly well received, supporting tools for financial inclusion such as 'progressive' and 'tiered' KYC.[51] It is nevertheless felt that this supporting guide must be updated to reflect the experience of developing countries in addressing digital financial inclusion.[52] In 2020, the Alliance for Financial Inclusion published a toolkit on inclusive financial integrity which further demonstrates areas in which additional guidance is necessary to support the integration of financial inclusion initiatives and financial crime controls.[53]

Guidance relating to the digital tools which can enable financial inclusion also require attention. The guidance on an RBA to prepaid cards, mobile payments and internet-based payment services was pioneering when it was published in 2013 but is increasingly out of date. It underlines the risk of non-face-to-face products and the risks emanating from the geographical reach of digital products. In an effort to fill the gap left by this guidance document, GSMA – the industry body for the telecommunications sector – has created its own certification for MMOs which includes a module on AML/CTF compliance.[54] Unlike the FATF guidance, this provides up-to-date criteria for fulfilling the FATF Standards in a way that complements the mobile money business model.

In recent years, guidance documents have more proactively considered financial inclusion. Of note is the FATF's guidance on digital ID, which makes strides in facilitating digital financial inclusion.[55] The guide removes the notion that remote verification is higher risk. Remote verification is favoured by digital financial service providers and helps to overcome the geographic hurdles faced by traditional bank networks and remote populations by allowing identification checks to be carried out using a

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49. FATF, 'FATF Guidance: Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion'; FATF, 'Prepaid Cards, Mobile Payments and Internet-Based Payment Services', June 2013, <https://www.fatf-gafi.org/media/fatf/documents/recommendations/Guidance-RBA-NPPS.pdf>, accessed 30 March 2021.
50. Research working group, 5 March 2021.
51. Authors' virtual interview with consultant H, 22 December 2020.
52. *Ibid.*
53. AFI, 'Inclusive Financial Integrity'.
54. GSMA, 'GSMA Mobile Money Certification: Defining and Promoting Excellence in the Provision of Mobile Money Services', 2018, <https://www.gsma.com/mobilefordevelopment/wp-content/uploads/2018/12/GSMA-Mobile-Money-Certification-Quick-Guide-English-1.pdf>, accessed 30 March 2021.
55. FATF, 'Guidance on Digital Identity', March 2020.

smartphone. Although this is a considerable step forward, FATF guidance documents are non-binding. To have the greatest possible impact, the interpretive note to Recommendation 10 must be updated to reflect this newfound flexibility.

There are two further shortcomings to FATF guidance documents which must be considered when assessing their impact on financial inclusion. First, they are mostly drafted by FATF member states (which are nearly all developed countries), so they tend to reflect the experience of those states and not those of developing ones.[56] As discussed above, developing countries might be less mature in their FATF compliance and may struggle to use guidance that does not bear this in mind. Second, FATF guidance documents are written in English and only translated into other languages when FSRBs or other international organisations do so, which is rare. Without translation, their accessibility and usefulness are greatly diminished.

Do FATF Standards Inhibit Digital Financial Inclusion?

At their core, FATF Standards do not inhibit digital financial inclusion. Rather, the Recommendations contain provisions which should enable financial inclusion, and the notion of the RBA should further bolster the use of these provisions. Most notably, SDD creates a pathway for disadvantaged groups to gain access to finance. It allows financial institutions to apply compliance procedures in proportion to the level of identified risk and, when possible, account for the challenges of working with low-risk disadvantaged groups.

It is in the implementation of the Standards that support for financial inclusion wanes, with few incentives to use SDD in an impacftul way. On several occasions, interviewees stressed a lack of confidence among regulated entities and regulators in using SDD, largely because the FATF framework provides little assurance that inaccurate application will not be met with censure. In practice, this apprehension results in a scenario where SDD is either part of a country's regulation but not authorised for use by regulators,[57] or where the provision is in place but regulated entities decide not to use SDD or do not correctly apply it, normally due to a lack of guidance.[58] Some entities may adopt a tiered system of KYC requirements for low-risk bank accounts which uses SDD,[59] but this is prescriptive and does not carry the flexibility inherent in the RBA.

Here, the FATF guidance documents could go further in providing the stewardship necessary to ensure that digital financial service providers can smoothly implement the FATF framework while enabling financial inclusion. Furthermore, the guidance documents are devised largely with the experience of

56. Authors' virtual interview with consultant H, 22 December 2020.
57. Authors' virtual interview with public sector body D, 20 November 2020.
58. Authors' virtual interview with international financial institution E, 5 October 2020; authors' virtual interview with international financial institution F, 5 October 2020; authors' virtual interview with financial institution B, 7 October 2020.
59. Asia Pacific Group (APG), 'Pakistan: Mutual Evaluation Report', October 2019, p. 101, <https://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/APG-Mutual-Evaluation-Report-Pakistan-October%202019.pdf>, accessed 30 March 2021.

developed countries and their digital financial environment in mind. In addition, the lack of translated versions of these documents – especially those of relevance to financial inclusion – is likely to have a negative impact on financial inclusion in non-English-speaking countries which cannot benefit from this additional insight.

III. The FATF Framework: Mutual Evaluation Process

THE EXTENT TO which a country has successfully implemented the FATF Standards is assessed via the mutual evaluation process.[60] This is a multi-stage, peer-reviewed process undertaken by the FATF or FSRBs approximately once every 10 years, culminating in a MER. This chapter evaluates how four of the stages of this process have impacted digital financial inclusion: the scoping exercise carried out by assessors ahead of their on-site visit; the preparatory work countries must do before being evaluated; the on-site visit itself; and the final report. These stages have been selected as they seemingly have the greatest impact on financial inclusion.

Prior to an analysis of these stages, it is important to consider whether the frequency of mutual evaluations impacts financial inclusion. Occurring approximately once every 10 years, the process has been shown to provoke a rush of activity as the evaluation approaches, which ebbs away once it has concluded.[61] This surge of activity can disrupt financial inclusion initiatives in lower-capacity countries where the resources available to policymakers are limited. Furthermore, should national authorities responsible for AML/CTF not coordinate with those responsible for financial inclusion, policies brought in specifically for the evaluation can contradict pre-existing financial inclusion initiatives.

Scoping Exercise

As one aspect of their extensive work prior to an on-site visit, assessors coordinate with national authorities to assemble a raft of contextual information in what is referred to as a scoping note. Assessors identify areas of higher risk to be scrutinised in more detail during their on-site visit of the assessed country, as well as areas of lower risk.[62]

60. FATF, 'Topic: Mutual Evaluations', <https://www.fatf-gafi.org/publications/mutualevaluations/?hf=10&b=0&s=desc(fatf_releasedate)>, accessed 30 March 2021.
61. Simon Bowers, '"Everyone Is Doing Badly", Anti-Money Laundering Czar Warns', International Consortium of Investigative Journalists, 11 May 2020, <https://www.icij.org/investigations/panama-papers/everyone-is-doing-badly-anti-money-laundering-czar-warns/>, accessed 8 April 2021.
62. FATF, 'Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems', updated November 2020, p. 17.

The exercise is an opportunity for the assessed country's national authorities to submit information on financial inclusion, but it does not by default require it. If assessed countries do not submit information on financial inclusion, due to the limited focus on financial inclusion in the assessment methodology, it is not a given that the topic will be considered in detail by assessors. Previously, it has been found that assessors only proactively pursue a greater understanding of financial inclusion as a factor of a country's AML/CTF regime if they have a personal interest in the topic or if financial exclusion has been identified as elevating a country's terrorist-financing risk.[63] Financial exclusion can fuel informal financial services, which are vulnerable to use for terrorist financing, an area of intense focus for the FATF.

In cases where financial inclusion is not considered as part of the scoping exercise, it is unlikely the topic will be at the forefront of assessors' minds. As a result, it could be argued that assessors are less likely to consider the negative impacts of excessive financial crime controls on financial inclusion.

Preparatory Work

In preparation for a mutual evaluation, countries should draft an NRA. It was noted by interviewees that the mutual evaluation process can influence the drafting of the NRA. They stated that there can be pressure to apply higher risk ratings to sectors and products than is necessary in the hope that this will provide protection from assessor criticism.[64] There is a sense that the benefits of this approach outweigh any negative impact on financial inclusion.

In addition to carrying out an NRA, countries may also choose to carry out an NRA of financial inclusion products. As well as monitoring the risks, these more specific NRAs can aid in the application of SDD by clarifying areas of lower risk. An interesting example of this can be found in a Tanzanian NRA of financial inclusion products. Of the 79 products considered within this assessment, only seven were rated as low risk.[65] For the financial inclusion of disadvantaged groups, the lack of low-risk products and services is likely to increase barriers to use. This would be acceptable if the risk assessment reflects a true representation of the level of financial crime risk posed by the products, but this NRA of financial inclusion products contains contradictory statements regarding the level of money-laundering/terrorism-financing risk for the listed financial inclusion products, which is likely to have a negative impact on their use.[66]

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63. Michael Pisa, 'Does the Financial Action Task Force (FATF) Help or Hinder Financial Inclusion? A Study of FATF Mutual Evaluation Reports', CGD Policy Paper No. 143, Center for Global Development, May 2019, p. 5.
64. Authors' virtual interview with public sector body A, 7 May 2020.
65. United Republic of Tanzania, Ministry of Finance and Planning, 'Financial Inclusion Products Risk Assessment Report', December 2016, <https://www.fiu.go.tz/TanzaniaNRAReport(Financial%20Inclusion%20Products%20Risk%20Assessment)Dec2016.pdf>, accessed 30 March 2021.
66. *Ibid.* Page vii states that it found seven products to be low risk, although in section 4.2 it is implied that 35 products could be rated as low risk.

On-Site Visit

The on-site visit is an opportunity for assessors to meet with a range of stakeholders on the ground to 'clarify issues relating to the country's AML/CFT system', review its effectiveness and address technical compliance issues.[67] The extent to which financial inclusion is considered at this stage is dependent on the assessors themselves.

Assessors who carry out the on-site visit are central to how financial inclusion is considered throughout the mutual evaluation process, but they receive limited formal training on this topic. Despite the core FATF assessor training including some references to financial inclusion, it is unclear whether the training covers digital financial services, their risks and opportunities, or whether it is standardised across FSRBs.[68] As the topic is new to many assessors, limited training on financial inclusion invites a 'risk of inconsistency in their approach to the topic'.[69]

During the on-site visit, interviewees reported that they felt an opportunity is missed by assessors to gain a greater understanding of how the FATF framework impacts financial inclusion. Interviewees gave few examples of financial inclusion being considered by assessors during their discussions with the public and private sectors. This absence of proactive conversations on the topic diminishes the opportunity for assessed countries to explain how their financial inclusion objectives are balanced against the requirements of the FATF framework – conversations likely to increase the chance that activities promoting financial inclusion are understood.

67. FATF, 'Procedures for the FATF Fourth Round of AML/CFT Mutual Evaluations', updated January 2021, p. 10.
68. Authors' virtual interview with NGO Q, 27 November 2020.
69. Global Partnership for Financial Inclusion, 'Global Standard-Setting Bodies and Financial Inclusion: The Evolving Landscape', March 2016, p. 79, <https://www.gpfi.org/sites/gpfi/files/documents/GPFI_WhitePaper_Mar2016.pdf>, accessed 30 March 2021.

Table 3: Treatment of Financial Inclusion During the On-Site Visit in Case Study Countries

Tanzania	Pakistan	Indonesia
Financial inclusion appears to have been considered to a limited extent by the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) assessors. In addition to consulting the NRA for financial inclusion products, the topic was raised at one private sector working group. Interviewees noted that there was confusion during the on-site visit in June 2019 about assigning risk to the informal financial sector – for example, village savings groups and other similar mechanisms. It is possible these mechanisms are low risk and can facilitate financial inclusion in a limited manner, but the onus appears to have been placed by assessors on officials to prove the absence of higher risk.	The on-site visit for the most recent MER took place in October 2018. Interviewees were not aware of financial inclusion being considered to a significant extent during the on-site visit. Interviews with providers of financial products intended to promote inclusion were audited on their financial crime controls but were not consulted on the benefits of their products for inclusion.	The on-site visit for the current mutual evaluation was scheduled for March 2021 but has been delayed by the coronavirus pandemic.

Source: Authors' interviews.

Final Report

The way countries are viewed by external parties is largely determined by the final report published following the mutual evaluation. The MER impacts how the country will be risk-rated by regulated entities and determines how much due diligence they will perform on the country and on transactions.[70] A positive MER enhances the credibility and integrity of the country's financial sector.[71] A negative report, on the other hand, is likely to adversely impact financial inclusion, inviting greater controls for those transacting with the country. Public sector interviewees reported feeling considerable pressure to ensure that their countries attained a positive write-up in the MER and were subsequently willing to sacrifice work on financial inclusion that might jeopardise this.[72]

The final report is also an opportunity for assessors to praise countries who have implemented the FATF framework effectively. As discussed above, however, research from the World Bank demonstrates

70. Authors' virtual interview with NGO L, 16 October 2020; authors' virtual interview with consultant E, 7 October 2020.
71. Authors' virtual interview with public sector body C, 18 November 2020.
72. Authors' virtual interview with public sector body C, 18 November 2020.

that MERs are disproportionally critical of the use of SDD.[73] For countries seeking to avoid criticism, this historic treatment of SDD may disincentivise its use even in circumstances where low risk has been identified.

Impact of the Mutual Evaluation Process on Digital Financial Inclusion

The mutual evaluation process has the potential to play a critical role in promoting financial inclusion, alongside the effective implementation of FATF Standards. However, the present methodology fails to embrace the opportunity to promote financial inclusion via this process. A limited understanding, particularly in lower-capacity countries, of how to use the process to benefit financial inclusion exacerbates this shortcoming.[74] It is not uncommon to see a less coordinated response to the mutual evaluation process in such countries, where 'passing the exam' is prioritised over taking a holistic approach to embedding FATF compliance into their financial ecosystems.[75]

When analysed by stage, the mutual evaluation process is shown to have several impacts on digital financial inclusion. Without consistent consideration of the topic, the work that goes into preparing for the mutual evaluation can have inadvertent impacts on financial inclusion. Nowhere is this starker than in the preparation of an NRA which, when poorly conducted, results in risk being inaccurately recorded. This is where digital financial inclusion can be most adversely affected, as products are given a higher risk rating than necessary.[76] On the ground, this results in stricter requirements for consumers and higher fees to access finance.

On-site visits by the mutual evaluation assessment team also miss an opportunity to further interrogate how assessed countries are promoting financial inclusion via the proportionate implementation of the FATF Standards. In addition, the MER can have significant repercussions for financial inclusion for a country. These influential documents are a key criterion in determining a country's perceived level of financial crime risk and thus inform the level of controls used by regulated entities to curtail this risk.

73. Çelik and Garcia, 'Unintended Consequences of the Global Standards on Financial Inclusion'.
74. Authors' virtual interview with international organisation E, 23 April 2020.
75. Authors' virtual interview with consultant E, 7 October 2020; authors' virtual interview with NGO I, 10 September 2020. It should be noted that taking a holistic approach would be resource intensive, especially for lower-capacity countries.
76. Authors' virtual interview with international organisation K, 3 December 2020.

IV. The FATF Framework: Listings Procedure

THE FATF LISTINGS procedure is commonly perceived to have a significant impact on financial inclusion.[77] Although there is limited data available to fully support this, anecdotal evidence and pre-existing literature suggest that this impact falls into three categories: policymakers trying to reverse a listing; repercussions for investment; and the impact on remittances.

What is a FATF Listing?

When a MER reveals substantial deficiencies in a country's AML/CTF framework, it may be incorporated into the FATF's International Co-Operation Review Group (ICRG) process.[78] The ICRG produces two lists of countries that have failed to meet the FATF Standards. The first consists of 'high-risk jurisdictions subject to call for action' known as 'the black list',[79] which includes countries that make insufficient political commitments to correcting their behaviour. The second, 'jurisdictions under increased monitoring', is referred to as 'the grey list' and includes countries who make a high-level political commitment to improving their identified deficiencies.[80]

Once countries become part of the ICRG process, they have a defined period to work with the FATF or the relevant FSRB to address their deficiencies under an action plan. When the requirements of the action plan are met, countries are removed from the review process. This is followed by an on-site visit to determine whether adequate legal, regulatory and operational reforms are in place, as well as the political will to sustain their implementation. Both lists are reviewed three times a year, in February, June and October.

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77. This sentiment was conveyed in several interviews conducted for this research.
78. FATF, 'More About the International Co-operation Review Group (ICRG)', <http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/more/moreabouttheinternationalco-operationreviewgroupicrg.html?hf=10&b=0&s=desc(fatf_releasedate)>, accessed 30 March 2021.
79. FATF, 'High-Risk Jurisdictions Subject to a Call for Action – February 2021', <http://www.fatf-gafi.org/publications/high-risk-and-other-monitored-jurisdictions/documents/call-for-action-february-2021.html>, accessed 30 March 2021.
80. FATF, 'Jurisdictions Under Increased Monitoring – February 2021', <http://www.fatf-gafi.org/publications/high-risk-and-other-monitored-jurisdictions/documents/increased-monitoring-february-2021.html>, accessed 30 March 2021.

Impact of a Listing on National Policymakers

Action plans can be damaging for financial inclusion if implemented too hurriedly. Pakistan, which was grey-listed by the FATF in 2018, offers a useful case study. Rapid reforms to align with action plan requirements were found to instigate a 'freezing', or paralysis, of the system as regulated entities sought to react to changing regulations and implement new policies and procedures.[81] As a result, compliance professionals were reported to be less willing to entertain innovative approaches to risk management or explore inclusive policies until reforms were integrated into policies and procedures. Moreover, financial institutions with existing business activities in Pakistan reassessed their RBA, leading to more conservative control applications across all respective business activities and a diminished appetite for new business.[82] Regulators may also be less open to engaging with new and innovative digital products,[83] as their focus turns to rectifying the country's listing.[84] In the case of Pakistan, the reaction to the grey-listing is likely to have had, and continue to have, negative impacts on financial inclusion. However, it is possible that these will not last long, as once the necessary reforms have been made, regulated entities may be more open to accommodating low-risk unbanked groups.

Impact of a Listing on Investment

The placement of a country on a FATF list is reported to have an adverse effect on investment. This can, in turn, impact financial inclusion in various ways.

At a national level, inclusion on a FATF grey or black list can make foreign capital more expensive or deter it entirely, impacting development and inclusion initiatives. The IMF and regional development banks for example, are obliged to ensure that recipients of their assistance are compliant with FATF's Standards.[85] A listed country might also find itself subject to increased or less desirable exchange rates.[86] In addition, re-acquiring public capital invested abroad can be more difficult for a listed country, as the jurisdiction in which the capital is invested can apply greater scrutiny to the funds.[87]A FATF listing will also negatively impact the perception of a country, increasing the likelihood that it could be downgraded by global credit agencies, or that

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81. Authors' virtual interview with mobile money operator A, 13 October 2020.
82. Authors' virtual interview with international financial institution I, 15 October 2020.
83. Authors' virtual interview with mobile money operator E, 6 November 2020.
84. Authors' virtual interview with financial institution B, 7 October 2020.
85. *Eurasian Times*, 'Pakistan's $6 Billion IMF Loan Can Get Cancelled If FATF Keeps Islamabad in Grey-List', 6 August 2019, <https://eurasiantimes.com/pakistans-6-billion-imf-loan-can-get-cancelled-if-fatf-keeps-islamabad-in-grey-list/>, accessed 30 March 2021; Economist Intelligence Unit, 'Economic Consequences of FATF "Grey Listing"', 30 October 2018, <https://www.eiu.com/industry/article/377308821/economic-consequences-of-fatf-grey-listing/2018-10-30%20 accessed%208%20April%202021>, accessed 30 March 2021.
86. Material provided by foreign government body B, 2020.
87. Authors' virtual interview with international organisation I, 15 October 2020.

its 'ease of doing business' score will suffer. Either outcome would make it more difficult for a country to borrow money that could be used for development.[88]

For the private sector, operating in a country that is subject to a FATF listing can upset investment that directly benefits digital financial inclusion. For example, digital financial services in Pakistan report finding it more difficult to attract investment from foreign venture capital to scale their businesses, due in part to the country's presence on the FATF grey list.[89]

Impact of a Listing on International Financial Services

The increased cost and perceived risk of maintaining relationships with a listed country has repercussions for the international financial services on offer to the listed country itself.[90] International banks can re-evaluate or withdraw the correspondent banking services they offer a listed country, making it more difficult for that country to transact across borders.[91] As correspondent banks enable the movement of remittances from abroad, which provides the funds necessary to use financial services, digital or otherwise, this can negatively impact financial inclusion.[92] If formal remittance services are withdrawn or made too expensive, take-up of informal services increases to fill the gap.[93] A consequence of a FATF listing can therefore be that international money flows are pushed outside the formal financial system and beyond the purview of the FATF framework, undermining its effectiveness.

It must also be noted that since 2020, inclusion on a FATF grey list will trigger being added to the EU's list of high-risk third countries. This list comes with stringent EDD measures and is likely to further impact the cost of sending remittances from the EU.[94]

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88. Authors' virtual interview with international organisation K, 3 December 2020.
89. Authors' virtual interview with consultant E, 7 October 2020; authors' virtual interview with FinTech H, 21 October 2020.
90. Louis de Koker, Supriya Singh and Jonathan Capal, 'Closure of Bank Accounts of Remittance Service Providers – Global Challenges and Community Perspectives in Australia', *University of Queensland Law Journal* (June 2017), pp. 119–54.
91. Material provided by foreign government body B, 2020.
92. Research working group, 5 March 2021.
93. Ross P Buckley and Rebecca L Stanley, 'Protecting the West, Excluding the Rest: The Impact of the AML/CTF Regime on Financial Inclusion in the Pacific, and Potential Responses', Working Paper No. 093/2016, Centre for International Finance and Regulation, January 2016.
94. European Commission, 'EU Policy on High-Risk Third Countries', <https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/anti-money-laundering-and-counter-terrorist-financing/eu-policy-high-risk-third-countries_en>, accessed 30 March 2021.

Summary

This research has aimed to supplement the available anecdotal evidence on the impact of FATF listings on traditional and digital financial inclusion. Based on interview data, it appears that the most significant impacts of a FATF listing for inclusion materialise when there is a hasty or misjudged reaction to entering the review process. In the case of Pakistan, hasty reforms have created a significant workload for both regulators and regulated entities, instilling a greater level of apprehension to accepting new businesses that could benefit financial inclusion.[95] In addition, a FATF listing appears to impact the confidence of regulators to work with digital financial services who might be supplying innovative financial products.[96] It should be noted that this effect of the FATF listing procedures does not stem from the FATF framework, but rather the domestic policymaking environment in a listed country.

The most direct impact on digital financial inclusion of being listed falls on investment in digital financial services, and on the cost for consumers of receiving money from abroad. Research on the impact of the latter has substantiated these costs and demonstrated that the FATF Recommendations have created 'significant concerns' for the remittance industry since their introduction in 2001.[97]

In all instances, more work needs to be carried out to establish quantitative indicators for the impact of FATF listings on investment and remittances. Without these indicators, the evidence base for the impact of FATF listings on financial inclusion will remain anecdotal.

95. Authors' virtual interview with mobile money operator A, 13 October 2020.
96. Authors' virtual interview with mobile money operator E, 6 November 2020.
97. Emiko Todoroki et al., *Making Remittances Work: Balancing Financial Integrity and Inclusion* (Washington, DC: World Bank, 2014).

V. The FATF Framework: Governance Structure

THE FOURTH ELEMENT of the FATF framework and its impact on digital financial inclusion considered by this paper is its governance structure. The FATF's figurehead is its president. Elected from one of its member states, the president sets the thematic priorities that the group will focus on during their two-year term. In addition, the president is the spokesperson for the group, attending multiple international forums such as the G20. The president is supported by the secretariat, who in addition to carrying out mutual evaluations and organising the group's plenary sessions, help to action the president's priorities. Outside the FATF, FSRBs each have secretariats who carry out work on priority topics for their region.

This chapter examines the role that FATF leaders have played in increasing awareness of financial inclusion as integral to the success of the FATF framework. It highlights past shortcomings and looks to the future to argue why emerging initiatives will be crucial to turning the tide for the FATF's relationship with financial inclusion.

FATF Presidents, 2012–19

FATF presidents, secretariats and FSRBs have had an inconsistent relationship with promoting financial inclusion. The introduction of the new Standards[98] and methodology[99] in 2012 provided the FATF with an opportunity to address the growing criticism that its framework was impacting inclusion and increasing derisking.[100] From 2012 to 2014, FATF presidents acknowledged financial inclusion in plenary speeches and by attending events such as the third high-level meeting on financial inclusion and global standard-setting bodies, where they reiterated the FATF's strong commitment to supporting financial inclusion goals.[101] Although meaningful at the time, this activity did little to change the perception that the FATF was mainly concerned with controlling risk and mandating blunt compliance with its Standards.

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98. FATF, 'The FATF Recommendations'.
99. FATF, 'Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems', updated November 2020.
100. Louis de Koker, 'Aligning Anti-Money Laundering, Combating of Financing of Terror and Financial Inclusion: Questions to Consider when FATF Standards are Clarified', *Journal of Financial Crime* (Vol. 18, No. 4, 2011), pp. 361–86.
101. FATF, 'FATF President Contributes to Global Standard-Setting Bodies' Discussion on Financial Inclusion', 2014, <http://www.fatf-gafi.org/publications/financialinclusionandnpoissues/documents/bcbs-meeting-2-october-2014.html>, accessed 30 March 2021.

After this initial period of activity, FATF presidents moved to address the derisking phenomenon that occurred between 2014 and 2016 by issuing further guidance and attempting to emphasise the proportionality afforded within the RBA.[102] Much-needed clarification was given to the issue of the risk posed by non-profit organisations, who had suffered the brunt of derisking.[103] Still, during this period, a greater emphasis on risk over proportionality was the prevailing FATF culture and the words of the president were not sufficient to counteract this perception.

FATF Presidents, 2019–Present

Since 2019, there has been a noticeable shift in the extent to which the FATF has addressed financial inclusion. As already mentioned, in 2019 the FATF's permanent mandate committed the group to promoting financial inclusion within its framework.[104] In the same year, it announced its strategic review – an interrogation of the FATF regime and the extent to which it fulfils its mandate. This created an opportunity to better understand its relationship with financial inclusion.[105]

In 2020, financial inclusion re-emerged in the priorities of the FATF president.[106] Although it is only mentioned in the final sentence of the president's priority document, this nevertheless indicates positive intent. Since the publication of these priorities, financial inclusion has risen further up the international policy agenda as the coronavirus pandemic lent a renewed urgency to grappling with the topic. The FATF has committed to supporting the work of the G20 on financial inclusion, a key aspect of their pandemic response.[107] By uniting with international organisations on this work, the FATF has not only moved closer to meeting its commitment but is also helping to unify the global response to financial exclusion which could be central to building inclusive financial integrity.

In March 2021, the FATF announced its project on unintended consequences.[108] This is designed to assess the nature of the FATF's unintended consequences on derisking, financial exclusion, the suppression of non-profit organisations and threats to fundamental human rights. Chaired by FATF Vice President Elisa de Anda Madrazo, the project will research why unintended consequences materialise from the incorrect implementation of the FATF Standards and propose solutions for correcting them. The project's announcement marks a decisive turning point for the FATF and its relationship with the negative consequences that may derive from its Standards. It signifies a shift towards taking a more holistic approach to improving the effectiveness of the

102. FATF, 'Correspondent Banking Services', October 2016; FATF, 'Combating the Abuse of Non-Profit Organisations (Recommendation 8)', June 2015.
103. FATF, 'Combating the Abuse of Non-Profit Organisations (Recommendation 8)'.
104. FATF, 'Mandate', 12 April 2019.
105. Lewis, 'Remarks at the RUSI Meeting on the Financial Action Task Force Strategic Review'.
106. FATF, 'Priorities for the Financial Action Task Force (FATF) Under the German Presidency', June 2020.
107. David Lewis, 'First G20 Finance and Central Bank Deputies Meeting, 25 January 2021', 1 February 2021, <https://www.linkedin.com/pulse/fatf-g20-david-lewis-frgs/>, accessed 30 March 2021.
108. FATF, 'Mitigating the Unintended Consequences of the FATF Standards'.

controls within the wider financial system, taking account of inclusive financial integrity as a key component of the FATF framework. The extent to which this project manages to cement this shift will depend on the impact of its outputs.

Role of FSRBs

In addition to the speeches made by the FATF presidency, FSRB secretariats play an important role in raising awareness of financial inclusion among their member states across the world. Of note, the Asia Pacific Group (APG), the Caribbean Financial Action Task Force (CFATF) and the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) all have workstreams that consider financial inclusion or derisking. The ESAAMLG has a working group on 'risk, compliance and financial inclusion'[109] that collaborates with international organisations to encourage proportionate implementation of the FATF Standards in line with the RBA.[110] The CFATF has undertaken a considerable amount of work on understanding derisking in the region, a phenomenon which impacts financial inclusion by constraining financial services.[111] It should be noted that all three FSRBs have prioritised work on financial inclusion, as exclusion is a prominent enough issue to justify the dedication of FSRB resources in their regions. With the exception of the Eurasian Group and the Central Africa Anti-Money Laundering Group, the remaining FSRBs have also worked on financial inclusion, but to a lesser extent.

Although FSRBs have endeavoured to raise awareness of financial inclusion and how it can be safeguarded within the FATF framework, their work has limited penetration. Country representatives attending plenary sessions and working groups on financial inclusion might be convinced of the benefits that better integration of inclusion considerations in financial crime regimes might have, but their domestic audience may not be as receptive.[112] Coordination between national stakeholders responsible for AML/CTF and financial inclusion can be fragmented, especially in lower-capacity countries where resources are already constrained. At best, stakeholders may collaborate on the NRA, but ongoing knowledge-sharing spurred by FSRB activity is less common.[113] To ensure greater partnership between these stakeholders, FSRBs and the FATF would benefit from engaging national financial inclusion stakeholders in their work and plenary sessions. By strengthening these bonds, the FATF could create a symbiotic environment for financial crime controls and financial inclusion.

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109. Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), 'Who We Are', <https://www.esaamlg.org/index.php/about>, accessed 30 March 2021.
110. Authors' virtual interview with international organisation E, 23 April 2020.
111. Caribbean Financial Action Task Force (CFATF), '"De-Risking" in the Caribbean Region – A CFATF Perspective', 2019, <https://www.cfatf-gafic.org/documents/resources/13667-de-risking-in-the-caribbean-region-a-cfatf-perspective/file>, accessed 30 March 2021.
112. Authors' virtual interview with international organisation I, 15 October 2020.
113. Authors' virtual interview with NGO Q, 27 November 2020.

Impact of the FATF Governance Structure on Digital Financial Inclusion

The FATF presidents, secretariats and FSRBs set the tone for compliance with the FATF framework. If the FATF wishes to support financial inclusion, as it has committed to in its mandate, the president and secretariats have a crucial role to play in communicating this to their member states.

To date, the tone from the top has not gone far enough to support financial inclusion within the FATF framework. The historical emphasis on risk and technical compliance has resulted in a disconnect in the minds of policymakers whereby financial crime controls and financial inclusion are not seen as mutually reinforcing. This is especially the case in countries where the link between inclusive financial integrity as a key defence against illicit financial flows is yet to be established.[114] The impact of this disconnect on financial inclusion is a lack of coordination between national stakeholders responsible for these policy areas, increasing the likelihood of contradictory policies.

However, developments in recent years demonstrate a marked change towards emphasising the effectiveness of the system, rather than just technical compliance. The announcement of the project on unintended consequences is especially significant and offers an opportunity to acknowledge the negative impacts which taking a solely technical approach to FATF compliance can have.

It is too early to make a judgement on whether this change in approach will create the environment for a more proportionate implementation of the FATF framework. It will take time to percolate through to FATF member states and their regulators and into the policies and procedures of regulated entities. More time still will be needed for this change to be communicated across the FSRBs and their memberships. It will be up to the FATF presidents, secretariats and FSRBs to champion financial inclusion within the FATF framework, endorsing the narrative at every opportunity that robust implementation of the FATF Standards alongside the promotion of financial inclusion is realistic and achievable.

114. *Ibid.*

Conclusion

THE FATF WAS never conceived as a tool to consider or drive financial inclusion. However, given the rise in its influence over the past 30 years, its expanding scope and the dynamics of the globalised economy, it cannot ignore that its framework has significant potential to improve – or undermine – financial inclusion. Acknowledging that financial inclusion both flourishes and is constrained by many separate and interconnected factors, this paper has assessed how significant financial crime controls set by the FATF have restricted digital financial inclusion.

The tools to enable access to digital finance via the RBA and SDD lie at the heart of the FATF regime. However, these tools can be constrained by poor implementation which the FATF could do more to avoid by providing greater clarity on their use and giving support to countries with less capacity to implement the nuances of their framework. The imbalance in country resources is a key area that requires greater attention from the FATF, especially as the disproportionate application of its Standards in such countries can have a significant impact on financial inclusion.[115]

This paper has examined four areas of the FATF framework to determine their impact on financial inclusion: the FATF Standards; the mutual evaluation process; the listing procedures; and the governance structure. It found that despite the existence of tools in the FATF Standards to support financial inclusion, they can be overlooked due to the resource-intensive prerequisites that must be in place to use SDD effectively, along with a lack of incentives that could drive adoption. The mutual evaluation process also overlooks the subject of financial inclusion, further reducing incentives for countries to prioritise policies that could promote inclusive financial integrity. The impact of FATF listings on digital and wider financial inclusion is anecdotally substantiated and would benefit from more robust data. The FATF's governance structure has had an uneven relationship with financial inclusion to date, at times pursuing activity that could promote it but more often overlooking it in lieu of other valid causes.

The FATF is re-examining its impact on financial inclusion. The announcement of its project on unintended consequences and the strategic review hold enormous potential for it to redefine its relationship with financial inclusion and how it can be safeguarded within the FATF regime. Ahead of the fifth round of mutual evaluations (due to begin in 2025), this moment of reflection could offer a rare opportunity to mitigate the unintended consequences that the FATF framework has had on financial inclusion.

To aid the FATF in considering potential steps to promote financial inclusion more proactively, the authors have laid out five recommendations for action in the accompanying Policy Brief. These call for: updates to the FATF Recommendations; updates to the FATF's methodology; more detailed training for assessors on financial inclusion; a detailed assessment of the impact of the ICRG process on financial inclusion; and for the FATF presidency to put actions behind their words of support for financial inclusion.[116]

115. Authors' virtual interview with international organisation I, 15 October 2020.
116. Chase and Keatinge, 'Walk the Talk: How the Financial Action Task Force Can Prioritise Financial Inclusion'.

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Appendix: Country Profiles

The following country profiles provide short summaries of the virtual case studies that inform this research. These condensed profiles provide highlights from the interviews conducted and do not reflect the findings from all interviews.

Tanzania

The findings in this profile are based on an extensive literature review and 23 semi-structured interviews held virtually between March and November 2020. Interviewees were selected from the public and private sectors, which included traditional financial service providers and digital services providers such as FinTechs and MMOs. A number of NGOs, charities and academics were also interviewed. In total, 32 people were interviewed, 43% of whom were women. Sensitivities around Tanzania's general election on 28 October 2020 restricted the willingness of interviewees to engage in this research.

Financial Inclusion Landscape

Almost half (46.8%) of those over the age of 15 have a financial account of some kind in Tanzania and 42.2% of women hold an account, above the regional average of 36.9%.[117] Tanzania is perceived to be a leader for financial inclusion in East Africa. The promotion of financial inclusion is driven by the National Financial Inclusion Council, chaired by the Bank of Tanzania. The Council's work centres around the National Financial Inclusion Framework 2018–22.

Barriers to inclusion include: low literacy levels; a lack of financial education; the availability and inaccessibility of bank branches; and the low penetration of smartphones. In rural areas, finance can be considered outside of the domain of women.

A lack of availability of official identity systems is a key barrier to financial inclusion in Tanzania. To combat this, the government has introduced a national digital ID scheme.

Digital Financial Inclusion

Tanzania is a world leader in the use of mobile money, with roughly 23 million subscribers in 2019. Mobile money is used to transact privately, pay bills and make business transactions.

117. World Bank, 'The Little Data Book on Financial Inclusion', 2018, p. 145, <https://globalfindex.worldbank.org/sites/globalfindex/files/countrybook/Tanzania.pdf>, accessed 27 May 2021.

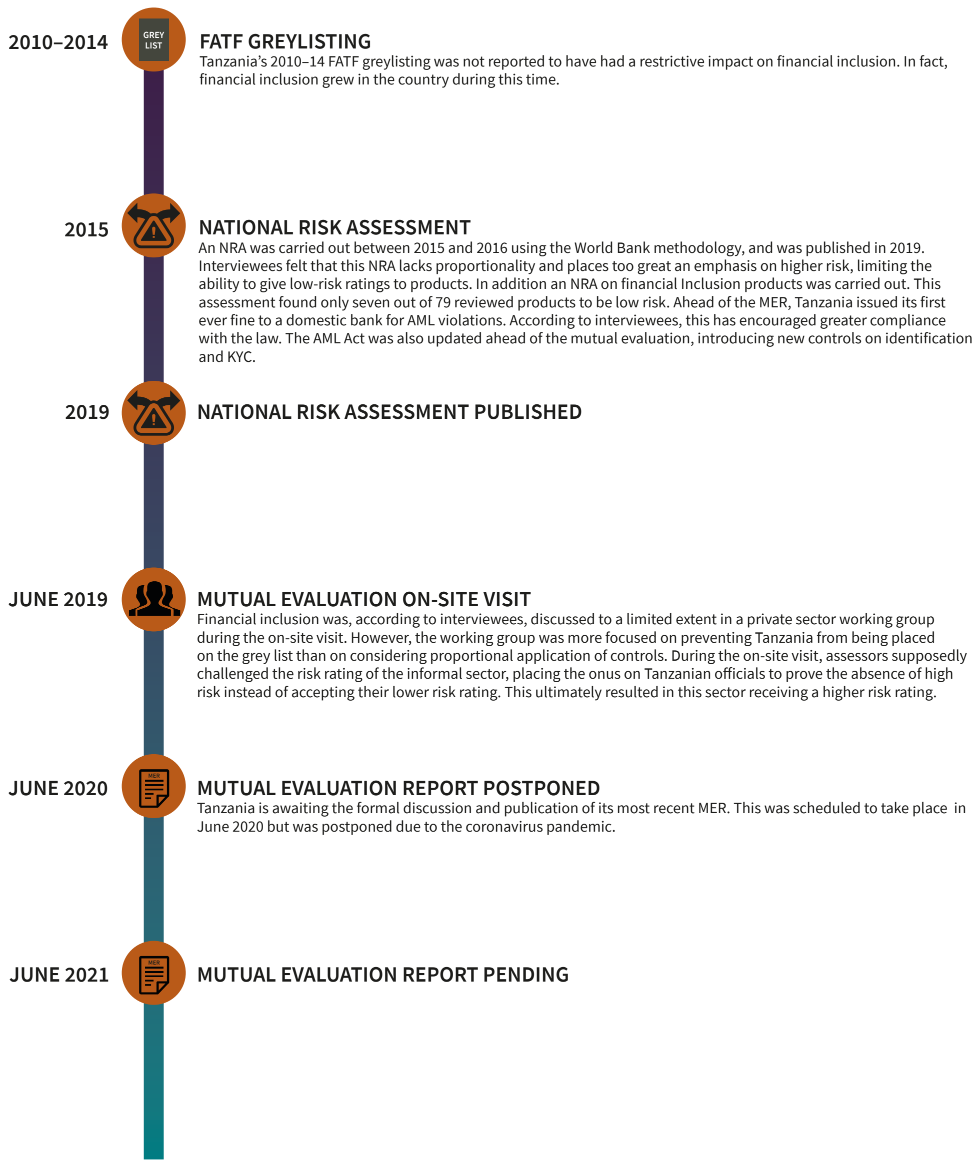
FinTech solutions are less advanced, faced with considerable barriers to entry in terms of cost and regulation. As a result, the fees associated with using FinTech products can be high, limiting their use by disadvantaged populations.

Financial Crime Threats

Tanzania has a large informal economy vulnerable to exploitation by criminals. Limited supervisory resources increase its exposure to money laundering, especially for the proceeds of the illegal drugs trade (trafficked across its porous borders), tax evasion and corruption. There have been very few convictions for money laundering in Tanzania. There are several instances where financial crime law has been used to target political opponents.[118]

118. US Department of State Bureau of International Narcotics and Law Enforcement Affairs, 'International Narcotics Control Strategy Report: Volume II – Money Laundering', March 2021, pp. 177–79.

Figure 2: Timeline of FAFT Activity in Tanzania



Source: Author generated.

FSRB: ESAAMLG

Tanzania is a member of the ESAAMLG. Financial inclusion and the need to bolster inclusive financial integrity is well understood by the ESAAMLG Secretariat. The ESAAMLG has a working group that meets once a year on risk, compliance and financial inclusion.

It was noted that despite a decent understanding of inclusive financial integrity within member state delegations and the Secretariat, delegations can find little appetite for addressing the issue when they return home.

Box 1: Key Impacts of Financial Crime Controls on Digital Financial Inclusion in Tanzania

- Tanzania's National Financial Inclusion Council is a constructive mechanism. However, it is yet to entrench a proper understanding that financial crime controls and financial inclusion are mutually beneficial. Better coordination across the government is needed for this to take place.

- The introduction of the national digital ID scheme is a positive step to further enabling financial inclusion, but the rollout has been haphazard. Urban areas appear to have been prioritised, leaving the rural population without this form of official identification.
    - Since the introduction of the new digital ID scheme, MMOs have been obliged to ensure that all mobile money accounts are linked to a digital ID. Without one, populations such as those in rural areas could face the suspension of their mobile money accounts, leaving them without the means to transact.
    - In addition, MMOs feel that they can no longer accept those more informal forms of identification that have proven vital for offering accounts to disadvantaged groups – removing their ability to onboard such populations. This negative implication for financial inclusion – although linked to due diligence – is the result of domestic rule-making, not the FATF framework, which allows for many forms of identification.

- Digital financial inclusion would be further aided by the proper implementation of the RBA, which is currently undermined by weaknesses in the NRA. Tanzania should consider performing a new up-to-date NRA for financial crime and financial inclusion products and ensure that it is shared with stakeholders in a timely fashion.

- Tanzania's regulators are relatively conservative when it comes to approving new financial products and require a somewhat drawn-out process for the approval of new products and services, which can stifle innovation. Regulators would benefit from better resourcing to ensure that they are adequately overseeing all the regulated sectors and have the capacity to explore the use of new financial technologies to support digital financial inclusion.

- International banks and telecommunications operators have played an important role in upskilling local regulators and regulated entities in their understanding of international financial crime standards. This knowledge is especially useful for events such as an ESAAMLG mutual evaluation.

- The current ESAAMLG mutual evaluation does not appear to have had a negative or positive effect on financial inclusion in Tanzania. Until the final MER is published, it is too early to make a definitive judgement on the impact of the FATF framework on digital financial inclusion in Tanzania.

Pakistan

The findings in this profile are based on an extensive literature review and 21 semi-structured interviews held virtually between February and November 2020. Interviewees were selected from the public and private sectors and included traditional financial service providers and digital services providers, such as FinTechs and MMOs. Several NGOs, charities and academics were also interviewed. In total, 28 people were interviewed, 25% of whom were women. Pakistan's current FATF greylisting created some limitations for the interview process with some reservations regarding engagement with external researchers.

Financial Inclusion Landscape

Out of those over the age of 15, 21.3% have a financial account of some kind, with 7% of women holding an account. The South Asian average for account ownership is 69.6%, with 64.1% for women.[119] The promotion of financial inclusion is the responsibility of the State Bank of Pakistan, which produces the National Financial Inclusion Strategy (NFIS). The NFIS sets targets for inclusion until 2023 and includes objectives for female financial inclusion.

Barriers to inclusion include: distrust of formal institutions; the efficiency of the informal financial sector; bureaucratic inertia in government agencies responsible for promoting financial inclusion; and low levels of digital skills in some segments of the population. Women, especially those in rural areas, face considerable cultural barriers to financial inclusion, including restrictions on mobile phone ownership and financial autonomy.

Digital Financial Inclusion

The use of digital financial services in Pakistan is growing but remains behind regional trends. Mobile money adoption is conservative, with 6.9% holding a mobile money account.[120] FinTech, outside of mobile money, has grown slowly, restricted by the regulatory framework and availability of investment. Pakistan has a well-established national ID scheme run through NADRA and its biometrically supported computerised (CNIC) and smart (SNIC) national ID cards, which can be used to access government-to-person payments and conduct basic transactions.

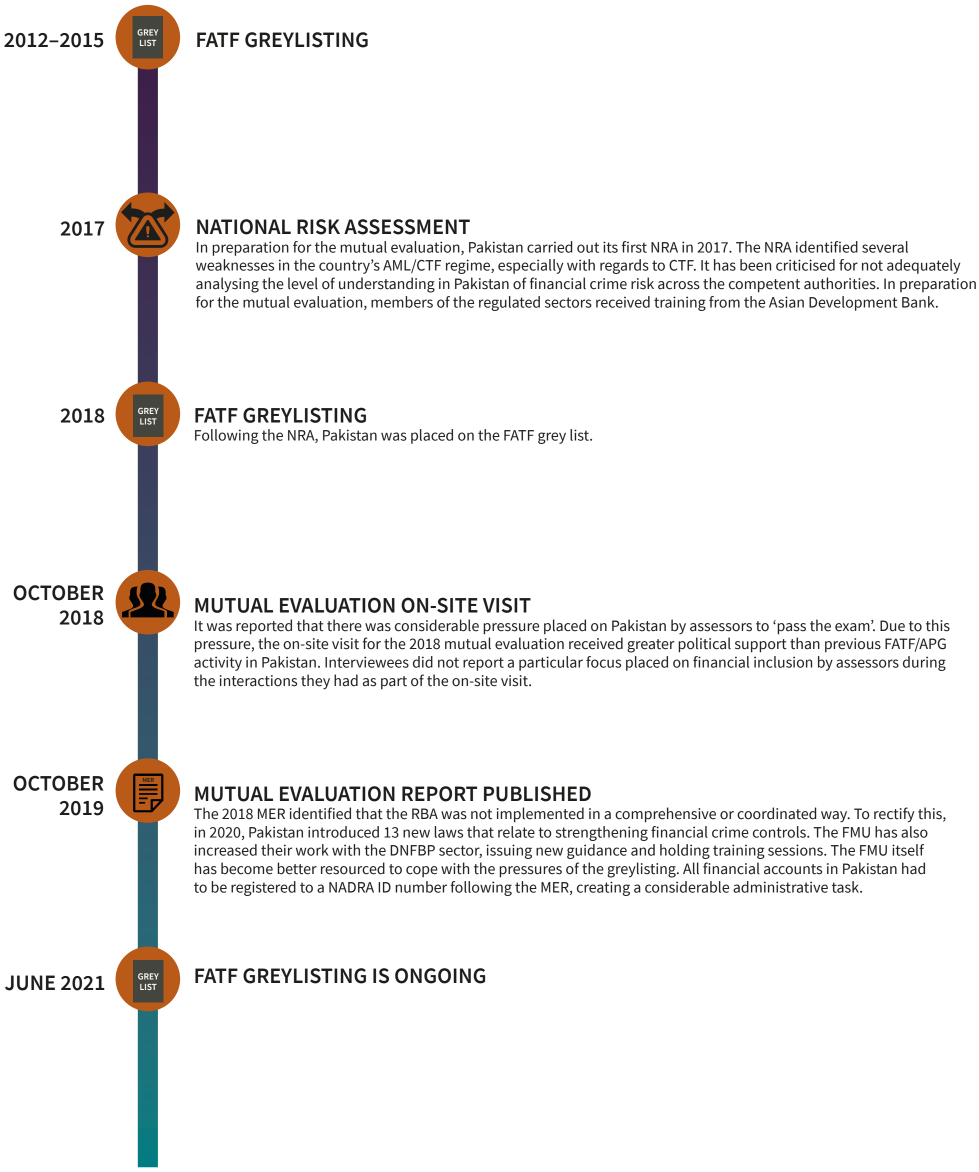
Financial Crime Threats

Pakistan's geographic location increases its risk of terrorist financing and narcotics smuggling. There is considerable risk of corruption, bribery and tax fraud. Pakistan has identified significant money-laundering weaknesses in its DNFBP sector, specifically in the trade of precious metals

119. World Bank, 'The Little Data Book on Financial Inclusion', p. 120.
120. *Ibid*.

and the real-estate sector. Pakistan has a considerable informal financial sector which is vulnerable to exploitation by criminals, especially via money transfer systems.[121]

Figure 3: Timeline of FAFT Activity in Pakistan



Source: Author generated.

121. US Department of State Bureau of International Narcotics and Law Enforcement Affairs, 'International Narcotics Control Strategy Report: Volume II – Money Laundering', pp. 149–51.

FSRB: APG

Pakistan is a member of the APG.[122] The APG is one of the most advanced FSRBs and provides technical assistance to Pakistan. The APG's Operations Committee considers issues relating to the implementation of the FATF Standards, which includes financial inclusion. In addition to assistance from the APG, Pakistan has received considerable assistance from external groups such as the World Bank, the IMF, ADB and independent consultants to improve its financial crime regime and enable its removal from the grey list.

Box 2: Key Impacts of Financial Crime Controls on Digital Financial Inclusion in Pakistan

- The NFIS is a useful framework for the promotion of financial inclusion, but interviewees were unsure of the extent to which it is being implemented in a meaningful way. This is reflected in the persistently low levels of financial inclusion in the country and the considerable size of the informal sector.

- Pakistan is still early on in its adoption of the FATF framework. This is reflected in the immaturity of its RBA and the level of understanding of financial crime threats. Interviewees reported that despite SDD featuring in legislation, there is limited awareness in how to use it effectively and in a way that could benefit inclusion.

- Digital financial services have been slow to thrive in Pakistan. Financial crime controls are one of many barriers to its adoption. Their impact on access to finance appear to be twofold:
    - Anxiety towards accepting new business:
        - The rapid introduction of new laws to meet the requirements of Pakistan's post-greylisting Action Plan and the deficiencies identified in the NRA have led to a 'freezing' of activity that could benefit financial inclusion. In practice, this manifests as caution in accepting new customers among compliance professionals, with many trying to ensure the right policies and procedures are in place before they entertain initiatives that might benefit financial inclusion.
        - It was reported that the current compliance environment has placed a huge strain on both regulators and compliance professionals to rapidly improve procedures. The requirement to re-verify the owners of all bank accounts is a good example of the considerable strain compliance professionals are under.
    - NADRA identification requirements for accounts:
        - The NADRA identification system requires biometric verification, which is most commonly reliant on a fingerprint. For manual labourers or the elderly,

122. In October 2020, the APG published its second follow-up report on Pakistan. While this noted a number of areas of progress in Pakistan's anti-financial crime architecture, there are no references to developments on financial inclusion, the use of SDD or other matters relevant to advancing financial inclusion. See APG, '2nd Follow-Up Report: Mutual Evaluation of Pakistan', adopted May 2021, <http://www.apgml.org/news/details.aspx?pcPage=1&n=3166>, accessed 7 June 2021.

fingerprints may not be viable enough to be used, resulting in the exclusion of these individuals from the benefits of the NADRA system and branchless banking accounts.

* The NADRA system is expensive for any growing digital financial services firms to interact with, and although there is a discounted rate for financial inclusion products, it is unclear whether this is used in practice.

- The FATF greylisting has had several impacts on digital financial inclusion. It was reported that it has increased the cost of receiving remittances. It has also made it much more challenging for digital financial services to attract foreign investment from venture capital firms. In addition, it makes it more difficult to attract loans from international organisations that could be used to fund development in Pakistan, which could benefit financial inclusion.

- In 2017, the New York State Department of Financial Services fined Pakistan-based Habib Bank Limited $225 million for AML/CTF violations, which also resulted in the bank losing their dollar clearing licence. This was a significant event for banks in Pakistan, prompting similar institutions to rapidly improve their compliance procedures. The fine and its consequences offer a useful example of the power of other external actors to initiate change in the domestic compliance landscape. It also underlines the importance of US financial crime standards, which tend to focus on higher risks over allowing flexibility that could enable financial inclusion.

- In sum, the FATF framework is having a noticeable impact on digital financial inclusion in Pakistan. However, it is possible that its effect will be short-lived and that once new financial crime policies, procedures and the RBA are better entrenched, financial inclusion could benefit from improved financial integrity brought about by stronger AML/CTF compliance.

Indonesia

The findings in this profile are based on an extensive literature review and 19 semi-structured interviews held virtually between February and November 2020, as well as an additional written response to the project concept note. Interviewees were selected from the public and private sectors, which included traditional financial service providers and digital services providers such as FinTechs and MMOs. Several NGOs, charities and academics were also interviewed. In total, 36 people were interviewed, 39% of whom were women.

Financial Inclusion Landscape

Almost half (48.9%) of those over the age of 15 have a financial account of some kind, with 51.4% of women holding an account, below the East Asia and Pacific average of 67.9%.[123] The promotion of financial inclusion is driven by the National Financial Inclusion Council (DNKI),

123. World Bank, 'The Little Data Book on Financial Inclusion', p. 75.

and the National Financial Inclusion Strategy (SNKI), published in 2016. In 2020, President Joko Widodo declared a new target for financial inclusion, aiming for 90% by 2022.[124]

Barriers to financial inclusion include: financial literacy; shortcomings in the national digital ID scheme; and data privacy and cyber security concerns.

Indonesia's geography creates significant challenges for financial inclusion. With roughly 17,000 islands, ensuring consistent financial services across all is difficult. High fees and distance to traditional bank branches can create further challenges for access, which is further constrained by the limited agent network.

Digital Financial Inclusion

A large part of the population – 178 million – have internet and smartphone access.[125] Among those in the country without a bank account, 69% own mobile phones.[126] FinTechs mainly penetrate urban areas and have struggled to establish effective agent networks in rural locations. Furthermore, fragmented infrastructure limits interoperability across digital platforms.

Although just 34.6% of adults made or received digital payments in 2017,[127] adoption of e-money is growing, accelerated by the coronavirus pandemic. The accumulative transaction value has risen from IDR 47 trillion in 2018 to IDR 145 trillion in December 2019.[128] Data from the financial regulator, OJK, shows that in August 2020, there was an increase in mobile banking transactions by 54.3% year on year.[129]

Financial Crime Threats

Vulnerability to money laundering stems from gaps in financial system legislation and regulation. Corruption and tax avoidance are also substantial risks, with most money laundering in the country related to corruption. In addition, the cash-based economy, coupled with a weak rule of law and the sometimes-limited effectiveness of law enforcement, also presents risks. Indonesia is also susceptible to narcotics abuse and the smuggling of illicit goods.[130]

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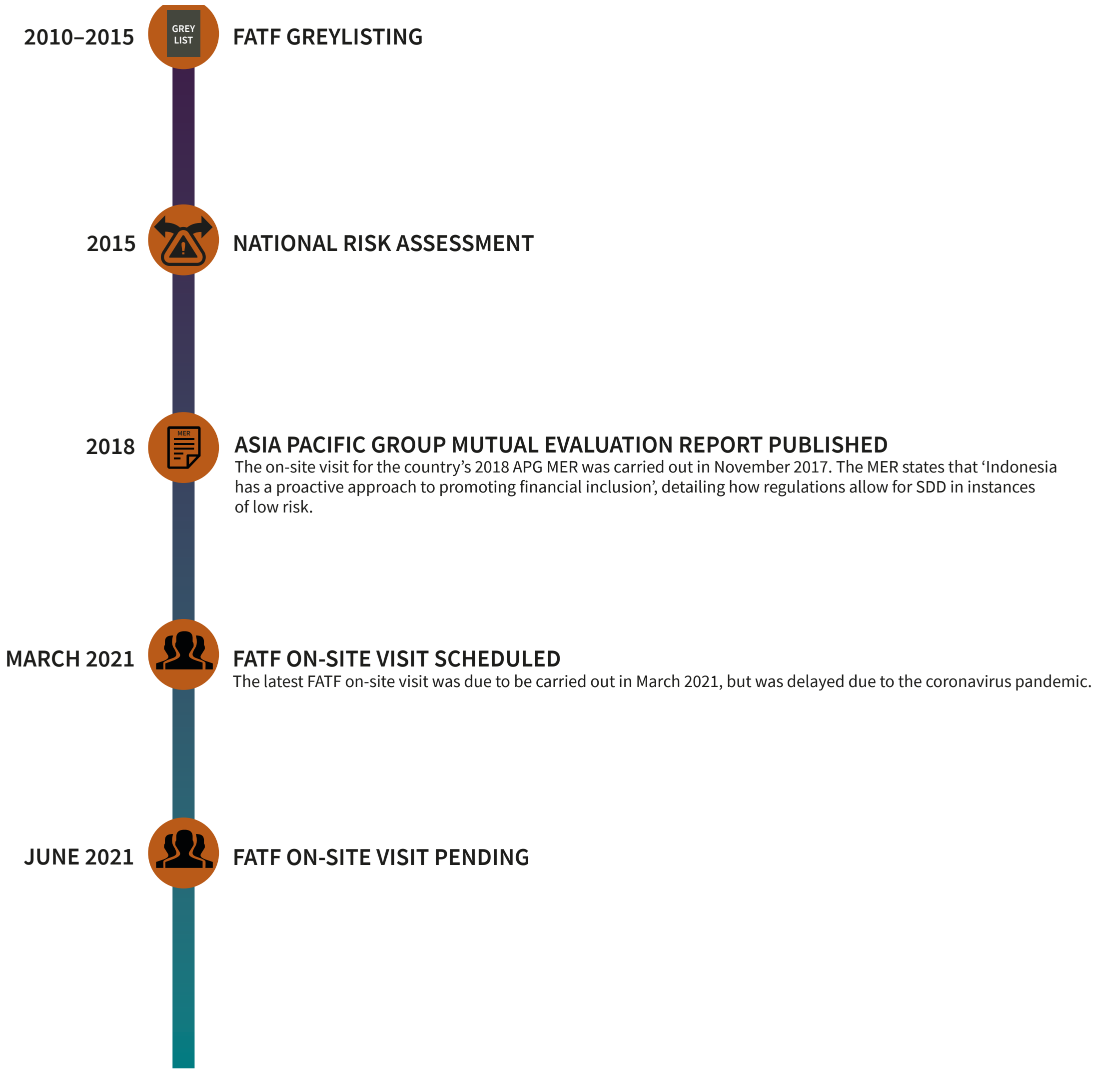
124. Asian Development Bank, '$500 Million ADB Loan to Expand Financial Inclusion in Indonesia', news release, 9 December 2020, <https://www.adb.org/news/500-million-adb-loan-expand-financial-inclusion-indonesia>, accessed 7 June 2021.
125. PwC Indonesia, 'Indonesia's FinTech Lending: Driving Economic Growth Through Financial Inclusion – Executive Summary', FinTech Series, June 2019, p. 2.
126. Fintech Indonesia, 'AFTECH Annual Member Survey Report 2019/2020', <https://fintech.id/dokumen/aftech-annual-member-survey-report-20192020>, accessed 7 June 2021.
127. World Bank, 'The Little Data Book on Financial Inclusion', p. 75.
128. Fintech Indonesia, 'AFTECH Annual Member Survey Report 2019/2020',
129. OJK, <https://www.ojk.go.id/en/Default.aspx>, accessed 7 June 2021.
130. US Department of State Bureau of International Narcotics and Law Enforcement Affairs, 'International Narcotics Control Strategy Report : Volume II – Money Laundering', pp. 113–15.

Figure 4: Timeline of FATF Activity in Indonesia



Source: Author generated.

FSRB: APG

Indonesia is a member of the APG. The APG’s Operations Committee, which examines money-laundering and terrorist-financing typologies and implementation issues, considers financial inclusion concerns and issues guidance.

Box 3: Key Impacts of Financial Crime Controls on Digital Financial Inclusion

- Indonesia has a relatively well-developed and entrenched AML/CTF regime, allowing for the use of SDD, a key factor for enabling financial inclusion. However, at present SDD is only permitted within government-backed initiatives and for opening basic e-money accounts which have transaction limits in place to curtail risk. The private sector would like greater flexibility to enable broader use of SDD and for this to be accompanied by better guidance.

- There is a perception among traditional financial service operators that they have a more mature grasp of financial crime controls than FinTechs. This has resulted in a cautious approach from the traditional banks to collaborating with FinTech providers.
    - FinTechs have implemented innovative approaches to onboarding with the potential to facilitate inclusion, including using videos and 'selfies' for identity verification. Greater clarity from regulators on how e-KYC can be used is a priority.

- The FinTech regulatory landscape creates complications for streamlining financial crime controls which could frustrate inclusion.
    - Different financial products offered by FinTechs fall under the remits of different regulators (Bank Indonesia, OJK or both), and each have their own guidance on KYC and AML. This can cause confusion on which checks need to be carried out, increasing the likelihood that more checks than necessary are carried out. Interviewees suggested that harmonisation between the two regulators on financial crime controls would be beneficial for streamlining compliance.
    - Although there is a collaborative relationship between regulators, interviewees mentioned a knowledge gap in regulators on how best to supervise FinTechs and how financial crime controls should be applied to them. Financial crime supervision has been delegated to the FinTech trade body, AFTECH, which is a member-led organisation with no specific expertise on balancing financial crime and financial inclusion objectives.

- Indonesia's digital ID scheme – the eKTP – holds enormous potential for financial inclusion, but much can be done to improve the scheme to increase its utility for financial crime compliance. Interviewees from across the financial sector said that the shortcomings in the eKTP scheme hinder effective financial crime compliance.
    - The eKTP scheme was the subject of a historic corruption scandal which impacted the procurement of the hardware related to the scheme.[§] Today, issues related to the hardware required to operate the IDs, as well as vendor lock-in and other contractual issues, increase the cost of using the eKTP system for financial crime compliance checks. In addition, the system currently only allows for limited use of biometrics.
    - The use of biometric information is especially important in Indonesia, as it is not uncommon for citizens to only have one name, which often triggers red flags in conventional financial crime risk-management software. As a result, these individuals generally find it more difficult to open financial accounts and would benefit from greater use of biometrics to enable them to be identified..

    - Wider use of biometric information and reducing the cost of accessing the eKTP database are critical to achieving more secure and rigorous onboarding at digital financial services providers, as this could allow for more inclusion while protecting against crime.

- It is important to note that while financial crime controls do impact financial inclusion to an extent, they are not the most pressing impediment to digital financial inclusion, especially regarding disadvantaged groups, who are predominantly constrained by geographical, connectivity and financial literacy hurdles.

§ Safrin La Batu, 'Indonesia's House Speaker Allegedly Involved in e-KTP Mega Corruption Scandal', Jakarta Post, 9 March 2017, <https://www.thejakartapost.com/news/2017/03/09/indonesias-house-speaker-allegedly-involved-in-e-ktp-mega-corruption-scandal.html.>, accessed 21 March 2021.