

POLICY BRIEF

# Walk the Talk: How the Financial Action Task Force Can Prioritise Financial Inclusion

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## ACKNOWLEDGEMENTS

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## EXECUTIVE SUMMARY

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The FATF has committed to promoting financial inclusion via the proportionate implementation of its standards.<sup>1</sup> The recent launch of a FATF project on unintended consequences, which includes a focus on financial exclusion, underlines that this commitment still requires attention. To date, beyond references to financial inclusion in the FATF Standards, methodology, guidance documents (on financial inclusion and related topics such as digital ID) and speeches, little concrete work has been done by the FATF to actively promote financial inclusion as part of its primary integrity mandate.<sup>2</sup>

This Policy Brief sets out five recommendations for how the FATF could refocus its framework so that it not only achieves its primary objective of effectively tackling financial crime but also actively promotes financial inclusion. Based on extensive research focused on three case study countries (see Appendix II for country profiles),<sup>3</sup> a review of the existing literature and interviews with key stakeholders,<sup>4</sup> the recommendations are as follows:

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1. Financial Action Task Force (FATF), 'Mandate', 12 April 2019, <<https://www.fatf-gafi.org/media/fatf/content/images/FATF-Ministerial-Declaration-Mandate.pdf>>, accessed 25 March 2021. The FATF Standards include the 40 FATF Recommendations and the accompanying Interpretative Notes which provide further details on how the Recommendations should be implemented.
  2. In 2017, the FATF released a guidance document to assist countries in applying the risk-based approach in a way that supports financial inclusion. See FATF, 'Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion, With a Supplement on Customer Due Diligence', November 2017. This guidance was an update of previous guidance from the FATF on financial inclusion, which was originally published in 2011 and updated in 2013.
  3. The case study countries are Tanzania, Pakistan and Indonesia. For more details, see Isabella Chase, Jonathan van der Valk and Tom Keatinge, 'Assessing the Financial Action Task Force's Impact on Digital Financial Inclusion', *RUSI Occasional Papers* (June 2021).
  4. This Policy Brief complements a RUSI Occasional Paper which details the project team's research on the impact that the FATF has had on the digital financial

1. Update FATF Recommendations 1, 2 and 10 to better promote compliance practices that enable financial inclusion.
2. Update the FATF methodology to incorporate a recognition of financial inclusion as contributing to the effectiveness of a country's anti-money-laundering and counterterrorist-financing regime.
3. Strengthen FATF assessor training on financial inclusion.
4. Measure the impact on financial inclusion of the International Cooperation Review Group process.
5. 'Walk the talk' – ensure all stakeholders understand that promoting financial inclusion is key to the successful implementation of the FATF framework.

The FATF should address these recommendations by devising its own financial inclusion strategy that creates a roadmap for how it, along with the outcomes from its unintended consequences project, will be introduced and sustained over time.

## INTRODUCTION

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The FATF exerts tremendous global influence. For countries and regulated entities (both financial and non-financial), it sets the standards for how financial crime and illicit finance should be curtailed,<sup>5</sup> thereby strengthening the integrity of the financial system. However, the FATF framework impacts not only *illicit* finance but also access to finance more generally.<sup>6</sup> In some cases, the disproportionate application of anti-money-laundering and counterterrorist financing (AML/CTF) measures can restrict legitimate access to finance entirely. Although this negative impact on financial inclusion is most often inadvertent, it should not be ignored. Given the influence the group wields, coupled with the financial pressures facing many countries, the FATF must take greater responsibility to reverse the unintentional impact that can emanate from the disproportionate application of its standards. With this in mind, the recent launch of the FATF's project on unintended consequences is welcome.<sup>7</sup>

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inclusion of disadvantaged groups. See Chase, van der Valk and Keatinge, 'Assessing the Financial Action Task Force's Impact on Digital Financial Inclusion'.

5. For FATF purposes, financial crime and illicit finance cover money laundering, terrorist financing and proliferation financing. The FATF also increasingly focuses on the proceeds of particular predicated offences such as the illegal wildlife trade and human trafficking.
6. This was highlighted by research in three case study countries. See Appendix II for their profiles.
7. In March 2021, the FATF announced a project on the unintended consequences of the FATF regime. See <<https://www.fatf-gafi.org/publications/financialinclusionandnpoissues/documents/unintended-consequences-project.html>>, accessed 25 March 2021.

At the January 2021 meeting of the G20 Finance and Central Bank Deputies, FATF Executive Secretary David Lewis said, ‘the more we can bring people into the formal financial system, the more we can follow the money that fuels crime and terrorism, and the better we can protect legitimate trade and financial flows between countries’.<sup>8</sup> The positive ramifications of promoting and ensuring financial inclusion for the integrity of the financial system are therefore acknowledged, but if real progress on meeting its commitment to promoting financial inclusion within its framework is to be made and sustained, it is necessary for the FATF to take more proactive steps, and actively prioritise the topic. Thus, not only should the FATF be assessing ways it can mitigate any negative impacts of its framework on financial inclusion, it must also ‘walk the talk’, leveraging its reach and influence to create an environment in which financial inclusion can advance.

Recognising that promoting financial inclusion is a supplementary aim to the FATF’s primary objectives of combating money laundering, the financing of terrorism and proliferation financing, this Policy Brief endeavours to aid the group in developing and advancing its thinking on this topic.<sup>9</sup> It will outline five areas within the FATF framework that require revision, not only to achieve the primary desired outcome of tackling financial crime but also to prioritise the protection and promotion of financial inclusion.

## METHODOLOGY

The policy recommendations made here use the FATF definition of financial inclusion to ensure that they are relevant to the FATF’s understanding of the topic.<sup>10</sup> However, it is recognised that the FATF definition of financial inclusion falls short of the more widely recognised definition, as it places too much emphasis on access to finance and not enough on the use and quality of financial services.<sup>11</sup>

This Policy Brief is supplemented by a RUSI Occasional Paper assessing the impact of the FATF on digital financial inclusion.<sup>12</sup> Both emanate from a

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8. David Lewis, speech at first G20 Finance and Central Bank Deputies meeting, 25 January 2021, <<https://www.linkedin.com/pulse/fatf-g20-david-lewis-frgs/?trackingId=0aht7%2BtSkou2Bfm8PCabgQ%3D%3D>>, accessed 25 March 2021.

9. In March 2021, the FATF announced a project on the unintended consequences of the FATF regime. It is hoped that this Policy Brief will supplement the pre-existing research that is available to the FATF working group.

10. FATF, ‘Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion, With a Supplement on Customer Due Diligence’.

11. A more widely used definition of financial inclusion places an equal emphasis on both access to services and use of them. Use of services is especially important to this debate as individuals must choose to use the formal financial sector instead of the informal financial sector which is outside the purview of the FATF regime. See Louis De Koker, ‘Editorial’, *Journal of Money Laundering Control* (Vol. 21, No. 3, 2018), pp. 250–52.

12. Chase, van der Valk and Keatinge, ‘Assessing the Financial Action Task Force’s Impact on Digital Financial Inclusion’.

two-year research project funded by the Bill and Melinda Gates Foundation, entitled 'Safeguarding Financial Inclusion by Strengthening Implementation of AML Standards'. Their findings are informed by an extensive review of the available literature and 90 interviews conducted virtually between March and November 2020 with a range of experts from around the world, including a particular focus on three case study countries, across the public, private and third sectors.<sup>13</sup>

This Policy Brief applies a policy-focused lens and proposes recommendations that aim to provide FATF member states with actionable policy ideas to be considered as part of the work of the FATF unintended consequences project and its Strategic Review.<sup>14</sup> As such, the intended audience is international and national-level policymakers who interact with the FATF regime.

## WHAT CAN THE FATF DO TO PRIORITISE FINANCIAL INCLUSION?

The FATF's recently announced project on unintended consequences, which includes a focus on financial exclusion in its terms of reference,<sup>15</sup> marks a step change in the group's approach to financial inclusion. Despite its longstanding commitment to promoting financial inclusion, the FATF's proactive engagement with the topic has been limited to date. As a supplementary goal to the group's core issues, financial inclusion is referenced in the Interpretative Notes to the FATF Recommendations, the methodology, speeches and in a specific guidance document on financial inclusion and customer due diligence.<sup>16</sup> These words encapsulate the FATF's relatively passive approach to the promotion of financial inclusion.

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13. The case study countries are Tanzania, Pakistan and Indonesia. These countries were selected using two criteria. First, the countries 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. Second, these countries have recently undergone a FATF or FATF-style regional body mutual evaluation or have had their evaluation postponed due to the coronavirus pandemic.
  14. The FATF working group on unintended consequences will analyse four areas where the FATF regime has had unintended consequences. One focus area is financial exclusion. To find out more about this working group and the FATF Strategic Review, see FATF, 'Mitigating the Unintended Consequences of the FATF Standards', <<https://www.fatf-gafi.org/publications/financialinclusionandnpoissues/documents/unintended-consequences-project.html>>, accessed 26 May 2021.
  15. For further details, see FATF, 'Mitigating the Unintended Consequences of the FATF Standards'.
  16. FATF, 'Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion, With a Supplement on Customer Due Diligence'.

The outcomes of the project on unintended consequences, expected in the second half of 2021 and contributing to the wider FATF Strategic Review, will present an important opportunity for the group to redefine its relationship with financial inclusion.<sup>17</sup> To make the most of this opportunity and take an active stance on financial inclusion, the FATF must review its framework and rhetoric on this topic – it must ‘walk the talk’. This Policy Brief sets out five recommendations for how this could be done. It proposes that, in sum, the FATF needs to create its own financial inclusion strategy to make committed and sustained progress.

## 1. UPDATE FATF RECOMMENDATIONS 1, 2 AND 10

The post-2012 FATF framework is based on 40 Recommendations which take a risk-based approach (RBA) to managing financial crimes.<sup>18</sup> In theory, this RBA should enable financial inclusion by allowing regulated entities to carry out compliance procedures in a proportionate manner, based on the level of identified risk. Where risk is perceived to be lower – such as for small village savings groups in rural areas – regulated entities have the flexibility to decide to simplify their due diligence measures.<sup>19</sup> In practice, however, the proportionality afforded by the regime is often lost in implementation due to the heavy emphasis placed on high risk in the wording of the 40 Recommendations. To correct this imbalance, Recommendation 1 and 10 must be revised.

To ensure that the flexibility to treat low-risk scenarios with appropriately tailored due diligence is used, Recommendation 1 should be updated to balance the language between the optional use of simplified due diligence (SDD) with the mandatory use of enhanced due diligence (EDD). Stakeholders in both the public and private sectors often face capacity challenges in assessing the financial crime risk associated with different forms of financial activity. As a result, they can lack the confidence provided by an accurate risk assessment that would allow them to implement SDD in identified low-risk scenarios. Without this confidence, and given that using SDD is optional, there is no incentive to develop the skills and policies necessary to use it. Furthermore, there is no reward within the FATF regime for acting proportionally towards low risk, but there are considerable penalties for any

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17. In 2019, the FATF announced that it would carry out a Strategic Review on how its evaluations of countries can better promote and enable more effective and efficient anti-money laundering and counterterrorist financing (AML/CTF) measures. The review occurs within the FATF forum and is set to conclude at the end of 2021. For more details, see David Lewis, speech at the RUSI Meeting on the Financial Action Task Force Strategic Review, London, 18 November 2019, <<https://www.fatf-gafi.org/publications/fatfgeneral/documents/rusi-fatf-strategic-review.html>>, accessed 25 March 2021.

18. FATF, ‘International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation: The FATF Recommendations’, updated October 2020, p. 10.

19. Chase, van der Valk and Keatinge, ‘Assessing the Financial Action Task Force’s Impact on Digital Financial Inclusion’.

failure to constrain elevated risk.<sup>20</sup> By using more encouraging language towards SDD, it is hoped that stakeholders would feel more incentivised to make use of this provision, building confidence and ultimately improving their implementation of the RBA.<sup>21</sup>

Digital tools have transformed financial inclusion, creating new avenues for people to access finance.<sup>22</sup> A barrier to the use of digital financial services, however, can be found in the Interpretive Note to Recommendation 10. Here, remote verification of identity – a key contributor to digital financial inclusion – is an example of higher financial crime risk.<sup>23</sup> This rating undermines the benefits that could be achieved for rural and lower-income communities who might gain from using remote verification methods – such as ‘selfie’ ID checks – to overcome geographic barriers to financial access. In 2020, the FATF published a guidance document on digital ID, which – subject to fairly strict assurance standards and product limits – removed the notion that remote verification is always high risk.<sup>24</sup> Although this is a positive development for financial inclusion, this guidance document is nonbinding. For its full effect to be felt, it is essential that the Interpretive Note to Recommendation 10 is revised to reflect this updated stance on remote verification.

In addition to updating Recommendations 1 and 10, financial inclusion would also benefit from revising Recommendation 2, which requires countries to ensure there is coordination between different financial crime government authorities when policies are being developed and implemented. Since 2018, this coordination has also included data-protection stakeholders. To reduce the impact of financial crime policies on financial inclusion and to make sure that policy development and implementation can grow symbiotically, it would be beneficial to update Recommendation 2 to include national authorities responsible for financial inclusion within the perimeter of national coordination.<sup>25</sup>

Updating these FATF Recommendations is no easy feat. The FATF system works on a consensus model and any amendments must be agreed by the 39 members.<sup>26</sup> FATF rhetoric suggests it should be axiomatic that promoting financial inclusion increases the integrity of the financial system. Yet, history demonstrates that the establishment of this connection by countries cannot be taken for granted and neither can their support be assumed for

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The FATF’s effort to promote financial inclusion would also benefit from a refresh of its methodology

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20. Isabella Chase, ‘Doing What is Right: Financial Inclusion Needs Better Incentives’, *RUSI Commentary*, 31 March 2020.

21. See Appendix I for suggested wording of Recommendation 1.

22. Timothy Lyman and Kate Lauer, ‘What Is Digital Financial Inclusion and Why Does it Matter?’, CGAP, 10 March 2015.

23. FATF, ‘The FATF Recommendations’, p. 68.

24. FATF, ‘Digital Identity’, March 2020, p. 30, para. 89.

25. See Appendix I for suggested wording.

26. For a list of the current members and observers of the FATF, see FATF, ‘Members and Observers’, <<https://www.fatf-gafi.org/about/membersandobservers/>>, accessed 25 March 2021.



objectives that fall outside the integrity mandate.<sup>27</sup> Thus, adjusting the FATF Recommendations to more explicitly safeguard financial inclusion is an important step, but one which may face considerable challenges.

## 2. UPDATE THE FATF METHODOLOGY

In addition to updating Recommendations 1, 2 and 10, the FATF's effort to promote financial inclusion would also benefit from a refresh of its methodology. In doing so, a basis could be created through which countries undergoing assessment can protect and promote financial inclusion during their mutual evaluation process. At present, whether and how inclusion is considered in a mutual evaluation is dependent on whether assessors identify financial exclusion risk as relevant to the evaluation.<sup>28</sup> Thus, to ensure a more consistent consideration of financial inclusion across all mutual evaluations, amendments should be made to the methodology. There are three areas of the mutual evaluation process in which this could be explored.

First, the scoping exercise for the mutual evaluation could provide an initial opportunity to galvanise much-needed coordination among national policymakers. As mentioned above, for financial inclusion and financial crime policies to be mutually beneficial, the national authorities who are responsible for these policy areas must work together. By requiring countries to submit information to the assessors on financial inclusion – covering both access and use – within the scoping exercise, the need to bring these stakeholders together would be established from the outset. The scoping exercise can also be used by countries to explain how financial inclusion is being prioritised alongside FATF compliance, providing important context for assessors about how they are likely to see the RBA materialise in that country. As the scoping exercise progresses, civil society could make use of the FATF's new engagement mechanism<sup>29</sup> to directly submit qualitative and, where possible, quantitative information to assessors to provide further detail on how financial crime controls are impacting financial inclusion in a country.<sup>30</sup>

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27. The establishment of the project on unintended consequences illustrates that countries can fail to recognise the need to balance financial inclusion with the implementation of the FATF framework. Authors' discussion with Virtual Expert Working Group, 5 March 2021.

28. Michael Pisa, 'Does the Financial Action Task Force (FATF) Help or Hinder Financial Inclusion? A Study of FATF Mutual Evaluation Reports', Center for Global Development (CGD), CGD Policy Paper No. 143, May 2019.

29. For details of this new mechanism, see FATF, 'Mutual Evaluations', <<https://www.fatf-gafi.org/faq/mutualevaluations/>>, accessed 25 March 2021.

30. For example, civil society groups could submit data on bank account closures experienced by disadvantaged groups or testimonies describing the availability of financial services. This information could provide assessors with greater contextual insights with which to determine the overall effectiveness of a country's AML/CTF regime. It is not for the FATF to make an overall judgement on the level of financial inclusion in a country but only to use this information to better inform its understanding of the effectiveness of the AML/CTF regime.



Second, there must be more recognition within published Mutual Evaluation Reports (MERs) for countries that make appropriate use of SDD and measures that promote financial inclusion. A recent study from the World Bank found that the way in which SDD is used tends to be criticised in MERs.<sup>31</sup> If the use of SDD is based on a sufficient RBA, the perception that its use represents a weakness in a country's AML/CTF regime reflects a fundamental misunderstanding by assessors of the risk posed by those products and entities. This must be corrected if the FATF is genuinely to promote and protect financial inclusion in its evaluation process. For example, MERs could be used to broadly praise countries that have taken financial inclusion into account in their national risk assessments or when countries have conducted a separate, high-quality, national risk assessment of financial inclusion products. Using MERs to highlight and promote best practices for using SDD and protecting financial inclusion would show other countries how financial inclusion can be aligned within the FATF's framework – and importantly, how taking these steps can benefit financial integrity and evaluation outcomes.

Third, if the FATF wishes to entrench financial inclusion within the mutual evaluation process, it must be ambitious and include a recognition of how its regime impacts financial inclusion in the effectiveness ratings it assigns. By capturing financial inclusion in the measurement of the effectiveness of a country's anti-financial crime framework, the FATF would cement the ethos that a financial system cannot be fully effective from an anti-financial crime perspective if people face financial exclusion. This would also highlight that controls are most effective when more people are included, thus achieving the FATF's desired outcomes.<sup>32</sup> To achieve this, the FATF must revisit Immediate Outcomes (IOs) 3 and 4 and consider the impact of supervision and preventative measures on financial inclusion. Specifically, it should be clarified that the actions taken to meet the requirements of these two IOs are only 'commensurate' with risk when related unintended consequences are proactively minimised.

Although incorporating a recognition of financial inclusion into the effectiveness rating would certainly encourage countries to take it more seriously, careful thought would be required on how this could be applied routinely across all assessments. As the FATF methodology states, 'assessment of effectiveness is not a statistical exercise', and both quantitative and qualitative data must be used to reach a judgement.<sup>33</sup> To be able to use quantitative indicators, assessors would require data points

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31. Kuntay Çelik and Valéria Salomão Garcia, 'Unintended Consequences of the Global Standards on Financial Inclusion', World Bank, 20 April 2021 (draft).

32. David Lewis, speech at the first G20 Finance and Central Bank Deputies Meeting.

33. FATF, 'Methodology: For Assessing Technical Compliance With the FATF Recommendations and the Effectiveness of AML/CFT Systems', updated November 2020, p. 19.

The recent introduction of online assessor training could create an opportunity for more specialised training modules to be developed and delivered

that are globally and uniformly available.<sup>34</sup> To use qualitative indicators,<sup>35</sup> they would require more in-depth training on financial inclusion to be able to reach a consistent conclusion.

### 3. STRENGTHEN FATF ASSESSOR TRAINING ON FINANCIAL INCLUSION

Assessors from the FATF and FATF-style regional bodies (FSRBs) play a determinant role in the FATF process. Not only do they assess the technical compliance of countries, but they also evaluate how effectively their anti-financial crime system operates. If a recognition of financial inclusion is to be more systematically included in the mutual evaluation process, assessor training will need to be strengthened so that assessors can, at the very least, appreciate the nuances of the country they are evaluating and the negative impacts that the FATF framework may have had on financial inclusion.

At present, FATF assessor training is limited to the critical elements of the mutual evaluation process. Assessors are given one week of intensive training which must cover all aspects of the FATF regime, leaving little room for financial inclusion to be covered in any depth. To correct this shortcoming, more detailed training on financial inclusion and how it can exist and thrive within the FATF framework should at least be made available to assessors who wish to understand it more fully.

It should be noted that there is also a range of specialised topics where further training for assessors would improve their ability to carry out assessments. The FATF Secretariat, however, has limited capacity to address these deficiencies, and producing additional training would require supplementary specialist resources. The recent introduction of online assessor training could create an opportunity for more specialised training modules to be developed and delivered, and allow assessors to expand their knowledge in a timeframe that suits them.<sup>36</sup>

### 4. MEASURE THE IMPACT ON FINANCIAL INCLUSION OF THE INTERNATIONAL COOPERATION REVIEW GROUP PROCESS

The International Cooperation Review Group (ICRG) process is perceived to have a negative impact on financial inclusion.<sup>37</sup> The ICRG produces what are

34. The World Bank Findex database is an example of a globally available data point that could be used to compare the level of financial inclusion across countries.

35. Such as interviews carried out by assessors during the onsite visit of a mutual evaluation.

36. For more details, see FATF, 'FATF Training and Support Activities', <<https://www.fatf-gafi.org/publications/fatfgeneral/documents/fatf-training.html>>, accessed 25 March 2021.

37. This sentiment was conveyed in several interviews conducted for this research. Despite the very limited qualitative data on the impacts of the International Cooperation Review Group (ICRG) process on countries, the anecdotal evidence suggests that a FATF listing has negative impacts on financial inclusion, especially with regard to the cost of remittances and attracting international investment.

known as the FATF black and grey lists.<sup>38</sup> When countries find themselves on either of these lists, they are subject to increased scrutiny by entities that wish to do business with them, resulting in greater compliance and associated expenses that raise the cost – and reduce the appeal – of doing business. For some commentators, the ICRG process is the primary driver of financial exclusion that emanates from the FATF,<sup>39</sup> although there is insufficient empirical evidence to prove or disprove this. Given its potentially significant impact on inclusion, the FATF must attempt to better understand the impact of the ICRG process. This Policy Brief suggests a three-pronged approach for how it could do so.

First, when placing a country into the ICRG process, the FATF should conduct an initial impact assessment to better understand where pressure from a FATF Action Plan (given to a country once it has been listed) could have a negative impact on the country's inclusion initiatives. To do this, the FATF must have a comprehensive understanding of the country's financial inclusion landscape when constructing action points and consider how different socioeconomic groups will be impacted. The FATF should work with civil society and financial inclusion stakeholders to inform this understanding.

Second, the FATF must consider whether the timeframe it demands for the completion of its post-listing Action Plan is reasonable. There is an understandable urgency from listed countries to do whatever it takes to be removed from a FATF list, but this urgency can have negative implications for financial inclusion. Reforms which are hurriedly introduced can lead to confusion in the regulated sectors, which in turn results in a nervousness in accepting new business. Balancing the need to apply pressure on listed countries and ensuring that listings do not impact financial inclusion is delicate and must be considered in greater detail by the FATF.

Finally, the FATF must consider performing a financial inclusion impact assessment either once a listing has been concluded or, in the case that a listing continues for years, during the listing period itself. The impact assessment could be based on a set of measurable indicators to understand

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This is explored in depth in Isabella Chase, Jonathan van der Valk and Tom Keatinge, 'Assessing the Financial Action Task Force's Impact on Digital Financial Inclusion', *RUSI Occasional Papers* (June 2021).

38. The 'black list' includes jurisdictions that have strategic AML/CTF deficiencies and to which countermeasures apply. The 'grey list' includes jurisdictions with strategic AML/CTF deficiencies that have not made sufficient progress in addressing the deficiencies or have not committed to an Action Plan developed with the FATF to address them. For more information, see 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\(fatf\\_releasedate\)>](http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/more/moreabouttheinternationalco-operationreviewgroupicrg.html?hf=10&b=0&s=desc(fatf_releasedate)>), accessed 25 March 2021.
39. Julia C Morse, 'Blacklists, Market Enforcement, and the Global Regime to Combat Terrorist Financing', *International Organisation* (Vol. 73, No. 3, 2019), pp. 511–45.

how the financial inclusion landscape in a listed country is impacted by steps taken to meet the Action Plan.<sup>40</sup> These indicators should be supplemented by interviews with relevant financial inclusion and financial crime stakeholders. The results of this final impact assessment could subsequently be compared with the initial version to help the FATF better understand the impact of their Action Plans on financial inclusion.

Understanding the impact of the ICRG process on financial inclusion will be an iterative process which must be refined over time. FATF member states will have to provide the flexibility necessary to experiment with different measures of impact and not expect the model to be perfect from the start. As these impact assessments are likely to be resource intensive, especially at inception, it is also important to consider who would be best placed to conduct them. It must be decided whether it would be appropriate for the FATF to carry out these assessments or if an external body would be better suited to the task.

## **5. TAKE ACTION TO ENSURE THAT ALL STAKEHOLDERS UNDERSTAND THAT PROMOTING FINANCIAL INCLUSION IS KEY TO THE SUCCESSFUL IMPLEMENTATION OF THE FATF FRAMEWORK**

To date, the FATF's passive approach to safeguarding financial inclusion has meant the issue has not received the profile it requires to flourish. As this Policy Brief has shown, there are systemic changes that can be taken by the FATF to encourage countries to more actively consider financial inclusion within their financial crime regimes. However, for real change to be achieved, the FATF must do more than make changes on paper alone.

The FATF must convince stakeholders that financial inclusion and the robust implementation of its framework are mutually beneficial. To do so, it needs to 'walk' this 'talk' and draw attention to the topic, emphasise this dynamic in speeches and at plenary events and, critically, ensure that mutual evaluation assessment teams are trained to recognise the important contribution financial inclusion can make to a country's anti-financial crime system and reflect this clearly in their evaluations. The FATF must also ensure that its new project on unintended consequences provides actionable solutions which are taken seriously by member states. It must consider what support countries in the Global South and those outside the central FATF body require to meet these twin objectives. To do this, it must support stakeholders in these regions with the resources they need to build a culture of compliance that encompasses financial inclusion alongside the implementation of its Standards.

To further amplify its voice, the FATF must take full advantage of the seats it has at influential tables, where it could do more to raise the profile of

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40. Indicators should be devised with input from the financial inclusion community and could involve, for example, the ability to use simplified due diligence in a country and the extent to which it is actually used.

financial inclusion within financial crime compliance. The G20 is one such forum. The current FATF president has shown a strong commitment to the G20 and has extended the FATF's support to its financial inclusion initiatives. When the FATF has these opportunities to 'speak truth to power', it should convey the challenges it faces in safeguarding financial inclusion within its system and perhaps request additional resources from such forums to make the necessary reforms.<sup>41</sup>

In addition to ensuring that financial inclusion stays in the minds of those with whom the FATF currently interacts, the FATF must check this includes all relevant parties. It must consider whether stakeholders – such as disruptive financial technology providers, who drive financial inclusion – are being listened to and consulted to the same extent as more traditional and influential financial service providers. This would guarantee that the FATF regime reflects the nature of the financial landscape it oversees.

Ensuring a consistent prioritisation of financial inclusion in the narrative that accompanies the FATF framework and its effective implementation will ultimately lie with the FATF president. However, each president has the freedom to set their own priorities at the beginning of each two-year term, meaning there is a danger that support for financial inclusion could wane over time as a new president seeks to set their own agenda.

## CONCLUSION

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The time for the FATF to make good on its commitment to promote financial inclusion through the proportionate implementation of its standards is ripe. The FATF should capitalise on the renewed global focus on financial inclusion and use its Strategic Review and project on unintended consequences to redefine its relationship with the topic. This Policy Brief offers five recommendations for how financial inclusion could be more deeply ingrained in the FATF regime.

These recommendations are not without their limitations. Any change to the FATF regime requires a consensus from its membership, which can be difficult to achieve. Despite financial inclusion being beneficial for all and already included in the FATF framework, adjusting a complex system could face some opposition. The FATF would need to provide the tools to smooth this process, but this is also not without its hurdles. The FATF and FSRB Secretariats have limited resources, so additional capacity would have to be found. Furthermore, the success of these recommendations will rely on strong sponsorship from the top. Each FATF president plays a crucial role

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41. David Lewis, speech at the Chatham House Illicit Financial Flows Conference, 1–2 March 2021, <<http://www.fatf-gafi.org/publications/fatfgeneral/documents/chatham-house-march-2021.html>>, accessed 25 March 2021. In this speech, Lewis calls for the FATF to be 'good civil servants, to speak truth to power and to point out where governments must do more'.

in communicating the spirit of the framework. Without their support, the notion that financial inclusion is central to the effective implementation of the FATF framework will be hollow.

A longer-term strategy is required to overcome these limitations and consider how the FATF regime could evolve in a more inclusive fashion. To set a clear direction and demonstrate commitment to ‘walking the talk’ on financial inclusion, the FATF should consider devising its own financial inclusion strategy. This should show how recommendations (such as those listed in this Policy Brief) and relevant outcomes from its project on unintended consequences could be introduced and sustained over time. As the group moves towards the fifth round of its mutual evaluations, this strategy could set out a vision for how the FATF can become synonymous with the curtailing of illicit finance while at the same time enabling licit finance – ensuring that no one is left behind.

## APPENDIX I

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The recommendations made in this Policy Brief call for a refinement of the FATF Standards. To achieve an approach that more proactively promotes financial inclusion, FATF Recommendations 1, 2 and 10 should be amended. In addition, revisions to the methodology would further entrench financial inclusion within the FATF Standards.

To spark a discussion on what these revisions could look like, this Policy Brief suggests changes to the wording of Recommendations 1, 2 and 10 which may proactively promote financial inclusion within the FATF Standards.

## SUGGESTED CHANGES TO THE FATF RECOMMENDATIONS

The following changes reference the FATF Recommendations 2012 (amended October 2020). Suggested additions are in bold and text that should be deleted has a line through it.

Page	Proposed Change	Notes
<b>Recommendation 1. Assessing Risks and Applying a Risk-Based Approach</b>		
p. 10	<p>Based on that assessment, countries should apply a risk-based approach (RBA) to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified <b>and limit unintended consequences such as financial exclusion and derisking.</b></p> <p>Where countries identify higher risks, they should ensure that their AML/CFT regime adequately addresses such risks. Where countries identify lower risks, they <del>may decide to</del> <b>should</b> allow simplified measures for some of the FATF Recommendations under certain conditions <b>and support their correct implementation with appropriate guidance.</b></p>	<p>By adding this suggested text, the notion that an RBA must both limit risk and unintended consequences would be better emphasised. It would be important for additional details to be provided on what is meant by 'unintended consequences'.</p> <p>In addition, by removing 'may decide' and replacing it with 'should', countries will be more strongly encouraged to use simplified measures, especially if this is supported by appropriate guidance.</p>



### Interpretive Note to Recommendation 1

p. 31

2. In implementing a[n] RBA, financial institutions and DNFBPs should have in place processes to identify, assess, monitor, manage and mitigate money laundering and terrorist financing risks. The general principle of a[n] RBA is that, where there are higher risks, countries should require financial institutions and DNFBPs to take enhanced measures to manage and mitigate those risks; and that, correspondingly, where the risks are lower, simplified measures ~~may~~ **should** be permitted, **and their correct implementation supported with appropriate guidance**. Simplified measures should not be permitted whenever there is a suspicion of money laundering or terrorist financing. Specific Recommendations set out more precisely how this general principle applies to particular requirements. ~~Countries may also, in strictly limited circumstances~~ **and** Where there is a proven low risk of money laundering and terrorist financing, **countries may also** decide not to apply certain Recommendations to a particular type of financial institution or activity, or DNFBP ... Equally, if countries determine through their risk assessments that there are types of institutions, activities, businesses or professions that are at risk of abuse from money laundering and terrorist financing, and which do not fall under the definition of financial institution or DNFBP, they should consider applying AML/CFT requirements to such sectors.

These suggested amendments reflect the proposed changes to Recommendation 1. In addition, it is recommended that 'in strictly limited circumstances' be removed as it is not clear why this should be applied if an appropriate national risk assessment has been carried out.

Recommendation 2. National Cooperation and Coordination		
p. 10–11	<p>Countries should ensure that policy-makers, the financial intelligence unit (FIU), law enforcement authorities, supervisors and other relevant competent authorities, <b>including authorities tasked with broadening financial inclusion</b>, at the policymaking and operational levels, have effective mechanisms in place which enables them to cooperate, and, where appropriate, coordinate and exchange information domestically with each other concerning the development and implementation of policies and activities to combat money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction. This should include cooperation and coordination between relevant authorities to ensure the compatibility of AML/CFT/CPF requirements with Data Protection and Privacy rules and other similar provisions (e.g. data security/ localisation).</p>	<p>By adding this suggested text, the range of stakeholders included in national coordination on financial crime matters would be expanded. In doing so, financial inclusion is more likely to be considered when financial crime policy evolves.</p>
Interpretive Note to Recommendation 2		
p. 37	<p>3. Inter-agency frameworks should include the authorities relevant to combating ML, TF and PF. Depending on the national organisation of functions, authorities relevant to such frameworks could include:</p> <ul style="list-style-type: none"> <li>a. The competent central government departments (e.g. finance, trade and commerce, home, justice and foreign affairs, <b>economic development agencies, including financial inclusion authorities</b>);</li> <li>b. Law enforcement, asset recovery and prosecution authorities;</li> <li>c. Financial intelligence unit;</li> <li>d. Security and Intelligence agencies;</li> <li>e. Customs and border authorities;</li> <li>f. Supervisors and self-regulatory bodies;</li> <li>g. Tax authorities;</li> <li>h. Import and export control authorities;</li> <li>i. Company registries, and where they exist, beneficial ownership registries; and</li> <li>j. Other agencies, as relevant.</li> </ul>	<p>The suggested amendments reflect the proposed change to Recommendation 2.</p>

### Interpretive Note to Recommendation 10

p. 69–70	<p>15. (c) Product, service, transaction, or delivery channel risk factors:</p> <ul style="list-style-type: none"> <li>• Private banking.</li> <li>• Anonymous transactions (which may include cash).</li> <li>• Non-face-to-face business relationships or transactions <b>which are not subject to suitable risk-mitigation measures such as digital identification with appropriate assurance levels.</b></li> <li>• Payment received from unknown or un-associated third parties.</li> </ul> <p>Lower risks. 15. (b) Product, service, transaction, or delivery channel risk factors:</p> <ul style="list-style-type: none"> <li>• Life insurance policies where the premium is low (e.g. an annual premium of less than USD/EUR 1,000 or a single premium of less than USD/EUR 2,500).</li> <li>• Insurance policies for pension schemes if there is no early surrender option and the policy cannot be used as collateral.</li> <li>• A pension, superannuation or similar scheme that provides retirement benefits to employees, where contributions are made by way of deduction from wages, and the scheme rules do not permit the assignment of a member's interest under the scheme.</li> <li>• Financial products or services that provide appropriately defined and limited services to certain types of customers, so as to increase access <b>and use</b> for financial inclusion purposes.</li> </ul>	<p>By adding this text, the Interpretive Note to Recommendation 10 would reflect the FATF's 2020 guidance on digital ID.</p> <p>By adding the suggested text, Recommendation 10 would account for both the access to and use of products that are beneficial for financial inclusion.</p>
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p. 71	<p>21. Where the risks of money laundering or terrorist financing are lower, financial institutions <del>could</del> <b>should</b> be allowed <b>and encouraged</b> to conduct simplified CDD measures, which should take into account the nature of the lower risk. The simplified measures should be commensurate with the lower risk factors (e.g. the simplified measures could relate only to customer acceptance measures or to aspects of ongoing monitoring). Examples of possible measures are:</p> <ul style="list-style-type: none"> <li>• Verifying the identity of the customer and the beneficial owner after the establishment of the business relationship (e.g. if account transactions rise above a defined monetary threshold).</li> <li>• Reducing the frequency of customer identification updates.</li> <li>• Reducing the degree of on-going monitoring and scrutinising transactions, based on a reasonable monetary threshold.</li> <li>• Not collecting specific information or carrying out specific measures to understand the purpose and intended nature of the business relationship but inferring the purpose and nature from the type of transactions or business relationship established.</li> </ul> <p>Simplified CDD measures are not acceptable whenever there is a suspicion of money laundering or terrorist financing, or where specific higher-risk scenarios apply.</p> <p><b>Supervisors should scrutinise decisions to employ or not employ SDD to understand whether there may be a need for supervisory clarification or regulatory reform to prevent unintended consequences.</b></p>	<p>By adding this suggested text, the use of SDD would be further encouraged, thus making it more likely to be used.</p> <p>In addition, the suggested text would place greater onus on supervisors to scrutinise decisions not to use SDD and how this impacts financial inclusion.</p>
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## SUGGESTED CHANGES TO THE FATF METHODOLOGY

The following changes reference the FATF Methodology 2013 (amended November 2020). Suggested additions are in bold and text that should be deleted has a line through it.

Page	Proposed Change	Notes
p. 6	<p>5. The starting point for every assessment is the assessors' initial understanding of the country's risks and context, in the widest sense, and elements which contribute to them. This includes:</p> <ul style="list-style-type: none"> <li>• the nature and extent of the money laundering and terrorist financing risks;</li> <li>• the circumstances of the country, which affect the materiality of different Recommendations (e.g., the makeup of its economy and its financial sector);</li> <li>• <i>structural elements</i> which underpin the AML/CFT system; and</li> <li>• <i>other contextual factors</i> which could influence the way AML/CFT measures are implemented and how effective they are (e.g., <b>the level of financial inclusion and the nature and extent of financial exclusion risks</b>).</li> </ul>	The addition of the suggested text would mean that assessors would more consistently include a consideration of financial inclusion in this initial stage of the mutual evaluation process.
p. 6	<p>8. Assessors should also consider issues of <i>materiality</i>, including, for example, the relative importance of different parts of the financial sector and different DNFBPs; the size, integration and make-up of the financial sector; <b>the level of financial inclusion</b>; the relative importance of different types of financial products or institutions; the amount of business which is domestic or cross-border; the extent to which the economy is cash-based; and estimates of the size of the informal sector and/or shadow economy. Assessors should also be aware of population size, the country's level of development, geographical factors, and trading or cultural links. Assessors should consider the relative importance of different sectors and issues in the assessment of both technical compliance and of effectiveness.</p>	The addition of the suggested text would mean that assessors would again consider financial inclusion at this stage of the mutual evaluation process.

p. 15	40. In the AML/CFT context, effectiveness is the extent to which financial systems and economies mitigate the risks and threats of money laundering, and financing of terrorism and proliferation, <b>whilst minimising unintended consequences, including negative impacts on financial inclusion</b> . This could be in relation to the intended result of a given (a) policy, law, or enforceable means; (b) programme of law enforcement, supervision, or intelligence activity; or (c) implementation of a specific set of measures to mitigate the money laundering and financing of terrorism risks, and combat the financing of proliferation.	By including the suggested text, the methodology would emphasise the idea that effectiveness can only be achieved if both financial crime and negative impacts on financial inclusion are curtailed.
p. 16	Immediate Outcome 3: Supervisors appropriately supervise, monitor, and regulate financial institutions and DNFBPs and VASPs for compliance with AML/CFT requirements commensurate with their risks <b>while minimising unintended consequences</b> .	The addition of the suggested text would mean that supervisors would have a greater responsibility to guard against unintended consequences, such as financial exclusion. It is hoped that by tasking them to do so, the need to protect financial inclusion would filter down to the regulated entities that they oversee.
p. 16	Immediate Outcome 4: Financial institutions, DNFBPs and VASPs adequately apply AML/CFT preventive measures, commensurate with their risks – <b>minimising unintended consequences</b> – and report suspicious transactions.	By adding the suggested text, the onus is placed on regulated entities to ensure that their compliance practices do not negatively impact financial inclusion.
<b>Technical Compliance Assessment</b>		
p. 24	1.8. Countries <del>may</del> <b>should</b> allow simplified measures for some of the FATF Recommendations requiring financial institutions or DNFBPs to take certain actions, provided that a lower risk has been identified, and this is consistent with the country's assessment of its ML/TF risks.	The suggested text reflects the authors' proposed changes to Recommendation 1 above.

p. 26	2.3. Mechanisms should be in place to enable policy makers, the Financial Intelligence Unit (FIU), law enforcement authorities, supervisors, and other relevant competent authorities <b>(including economic development and financial inclusion authorities)</b> to co-operate, and where appropriate, co-ordinate and exchange information domestically with each other concerning the development and implementation of AML/CFT policies and activities. Such mechanisms should apply at both policymaking and operational levels.	The suggested text reflects the proposed changes to Recommendation 2.
p. 102	Supervisors provide financial institutions, DNFBPs and VASPs with adequate feedback and guidance on compliance with AML/CFT requirements. Over time, supervision and monitoring improve the level of AML/CFT compliance, and discourage attempts by criminals to abuse the financial, DNFBP and VASP sectors, particularly in the sectors most exposed to money laundering and terrorist financing risks. <b>In addition, measures are taken to ensure that compliance is proportional to risk and that compliance practices that clearly exceed the expectations of the FATF framework are identified and appropriately addressed, minimising unintended consequences.</b>	By adding this suggested text, supervisors should be encouraged to take a more proportional approach to supervision, reducing the risk of entities disproportionately complying with the FATF Standards.
p. 104	8. What measures and supervisory tools are employed to ensure that financial institutions (including financial groups), DNFBPs and VASPs are regulated and comply with their AML/CFT obligations (including those which relate to targeted financial sanctions on terrorism, and to countermeasures called for by the FATF)? To what extent has this promoted the use of the formal financial system? <b>To what extent has this driven financial exclusion?</b>	By adding this suggested text, supervisors should be encouraged to take a more proportional approach to supervision, reducing the risk of entities disproportionately complying with the FATF Standards.



p. 106	Financial institutions, DNFBPs and VASPs understand the nature and level of their money laundering and terrorist financing risks; develop and <b>proportionately</b> apply AML/CFT policies (including group-wide policies), internal controls, and programmes to adequately mitigate those risks; apply appropriate CDD measures to identify and verify the identity of their customers (including the beneficial owners) and conduct ongoing monitoring; adequately detect and report suspicious transactions; and comply with other AML/CFT requirements. This ultimately leads to a reduction in money laundering and terrorist financing activity within these entities.	By adding this text, the need for proportionate application of AML/CFT policies would be emphasised, better safeguarding financial inclusion.
p. 107	4.2 How <del>well</del> <b>effectively and efficiently</b> do financial institutions, DNFBPs and VASPs apply mitigating measures commensurate with their risks?	The use of the term 'well' here is vague. The addition of the suggested text would provide scope to the meaning.
p. 107	4.3 How <del>well</del> <b>effectively and efficiently</b> do financial institutions, DNFBPs and VASPs apply the CDD and record-keeping measures (including beneficial ownership information and ongoing monitoring)? <b>Are CDD measures designed to address higher risks and respond to lower risks?</b> To what extent is business refused when CDD is incomplete <del>measures cannot be completed?</del> <b>Do SDD measures appropriately support national financial inclusion policies?</b>	The use of the term 'well' here is vague. The addition of the suggested text would provide scope to the meaning.. Further specific questions are also suggested to ensure that financial inclusion is being considered.
p. 107	4.4 How <del>well</del> <b>effectively and efficiently</b> do financial institutions, DNFBPs and VASPs apply the enhanced or specific measures for: (a) PEPs, (b) correspondent banking, (c) new technologies, (d) wire transfer rules, (e) targeted financial sanctions relating to TF, and (f) higher-risk countries identified by the FATF?  <b>4.4b How effectively and efficiently do financial institutions, DNFBPs and VASPs apply the simplified measures or exemptions for: (a) low-risk scenarios, and (b) new technologies used for financial inclusion purposes?</b>	The use of the term 'well' here is vague. The addition of the suggested text would provide scope to the meaning. A subpoint has been added to ensure that simplified measures and exemptions are more appropriately treated by the mutual evaluation process.

## APPENDIX II

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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

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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%.<sup>42</sup> 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.

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42. 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.

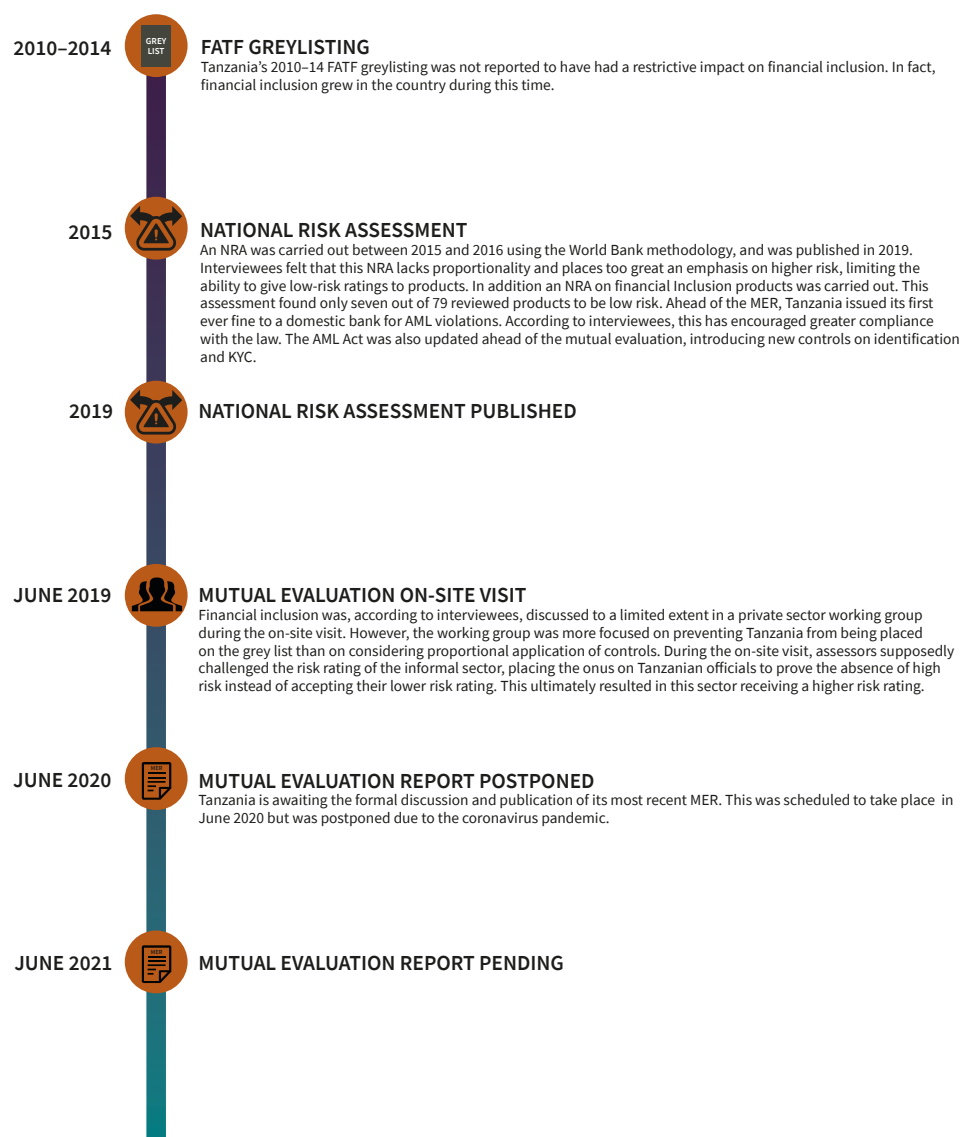


## FINANCIAL CRIME THREATS

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.<sup>43</sup>

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43. 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 1: 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

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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.<sup>44</sup> 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.<sup>45</sup> 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 and the real-estate sector. Pakistan has a considerable informal financial sector

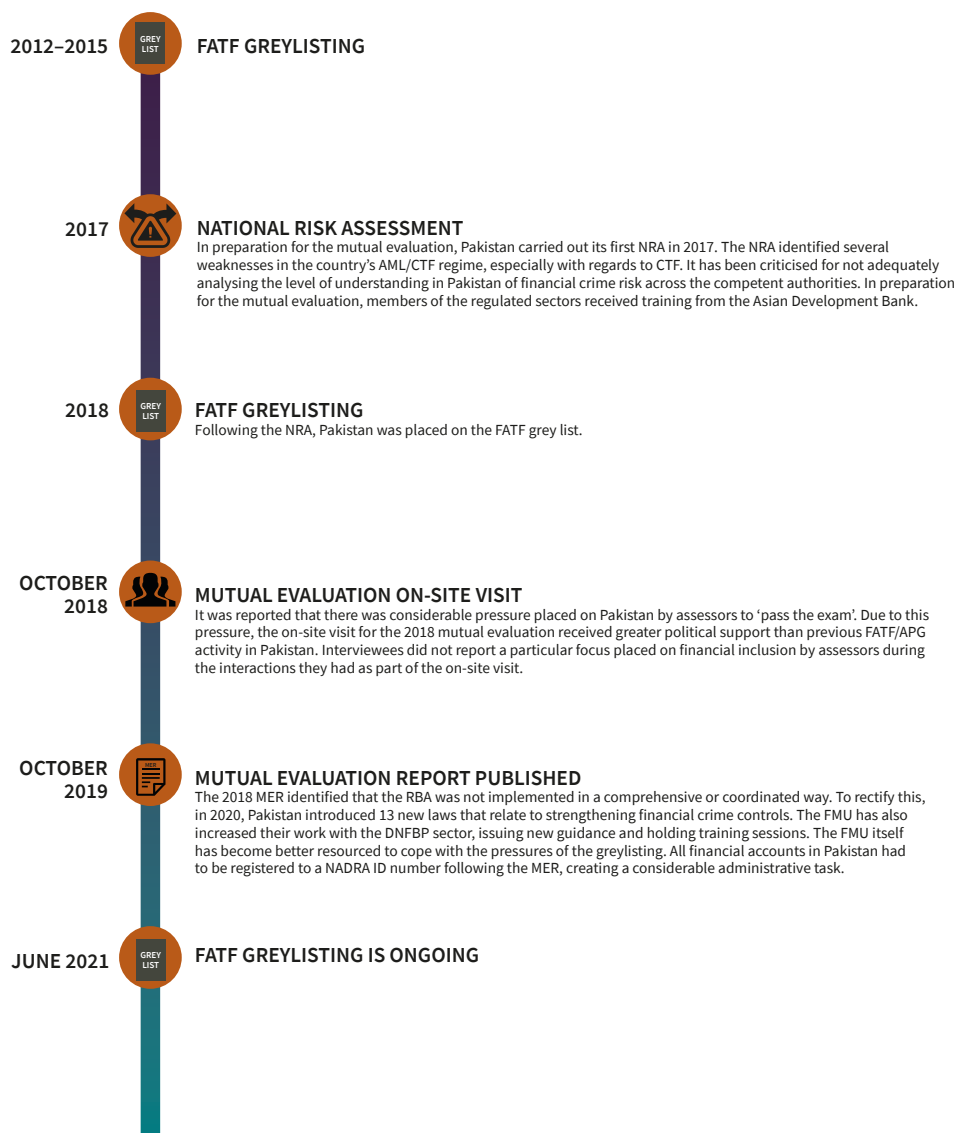
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44. World Bank, 'The Little Data Book on Financial Inclusion', p. 120.

45. *Ibid.*

which is vulnerable to exploitation by criminals, especially via money transfer systems.<sup>46</sup>

**Figure 2: Timeline of FATF Activity in Pakistan**



Source: Author generated.



FSRB: APG

Pakistan is a member of the APG.<sup>47</sup> The APG is one of the most advanced FSRBs and provides technical assistance to Pakistan. The APG's Operations

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

47. 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



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, 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.

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use of SDD or other matters relevant to advancing financial inclusion. See APG, '2<sup>nd</sup> 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.

\* 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%.<sup>48</sup> The promotion of financial inclusion is driven by the National Financial Inclusion Council (DNKI), and the National Financial

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

Inclusion Strategy (SNKI), published in 2016. In 2020, President Joko Widodo declared a new target for financial inclusion, aiming for 90% by 2022.<sup>49</sup>

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.<sup>50</sup> Among those in the country without a bank account, 69% own mobile phones.<sup>51</sup> FinTechs mainly penetrate urban areas and have struggled to establish effective agent networks in rural locations. Furthermore, fragmented infrastructure limits interoperability across digital platforms.

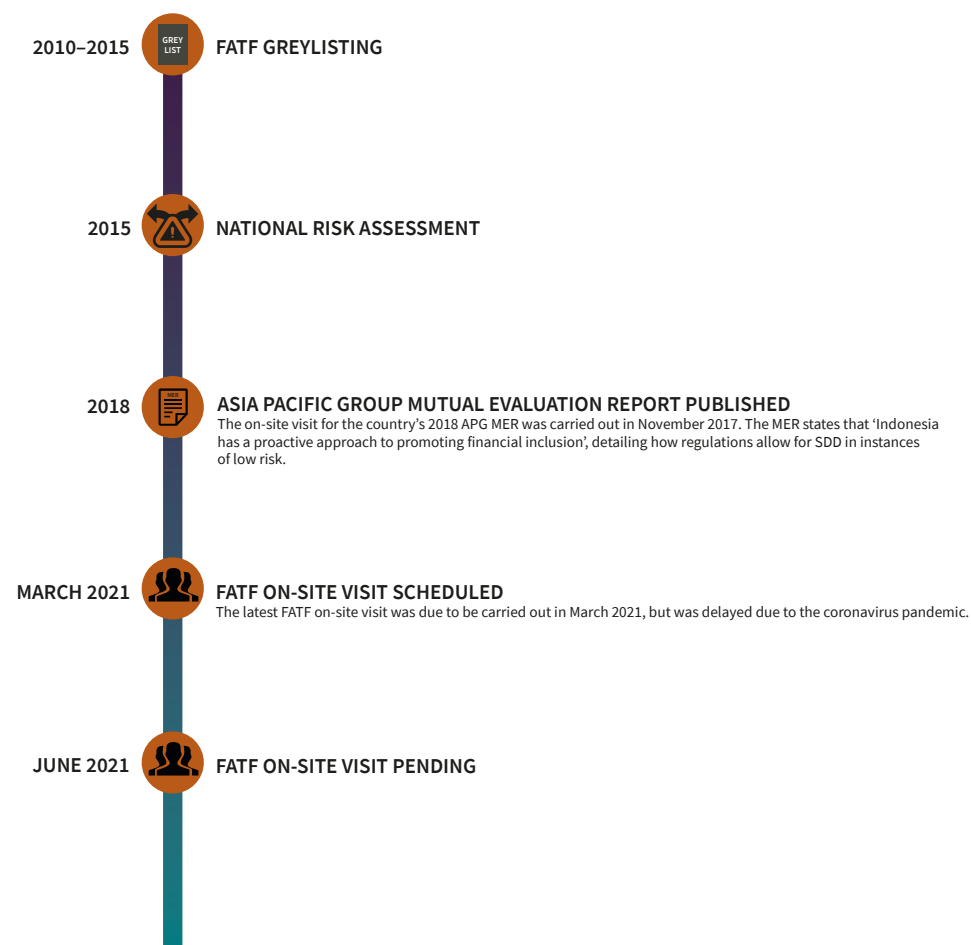
Although just 34.6% of adults made or received digital payments in 2017,<sup>52</sup> adoption of e-money is growing, accelerated by the coronavirus pandemic. The accumulative transaction value has risen from IDR 47 trillion in 2018 to IDR 145 trillion in December 2019.<sup>53</sup> Data from the financial regulator, OJK, shows that in August 2020, there was an increase in mobile banking transactions by 54.3% year on year.<sup>54</sup>



## 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.<sup>55</sup>

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- 49. 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.
  - 50. PwC Indonesia, 'Indonesia's FinTech Lending: Driving Economic Growth Through Financial Inclusion – Executive Summary', FinTech Series, June 2019, p. 2.
  - 51. Fintech Indonesia, 'AFTECH Annual Member Survey Report 2019/2020', <<https://fintech.id/dokumen/aftech-annual-member-survey-report-20192020>>, accessed 7 June 2021.
  - 52. World Bank, 'The Little Data Book on Financial Inclusion', p. 75.
  - 53. Fintech Indonesia, 'AFTECH Annual Member Survey Report 2019/2020',
  - 54. OJK, <<https://www.ojk.go.id/en/Default.aspx>>, accessed 7 June 2021.
  - 55. 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 3: 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 remit 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.<sup>5</sup> 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.*

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