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GUIDANCE NOTE NO 1 OF 2017

UNDERSTANDING DE-RISKING, ITS IMPACT AND RELEVANT FIC GUIDANCE

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A. DEFINITIONS AND ACRONYMS

"Accountable (AI) or Reporting institution (RI)" means a person or entity listed in schedules 1 or 3 of the Act;

"Act" refers to the Financial Intelligence Act, 2012 (Act No. 13 of 2012) as amended;

"Basel Committee" means the committee established by international banking regulators who provides a forum for regular cooperation on banking supervisory matters. Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide;

"Business relationship" means an arrangement between a client and an accountable or reporting institution for the purpose of concluding transactions on a regular basis;

"CDD" means Customer Due Diligence;

"Client and Customer" have their customary meaning and are used interchangeably;

"Correspondent banking relationships or CBRs" within this context, refers to a relationship between two correspondent banks. This relationship enables the provision of banking, payment and other services by one bank "the correspondent bank" to another bank "the respondent bank" to enable the latter to provide services and products to its clients;

"Correspondent institution/bank" within the context of this document, a correspondent bank or institution is one that provides banking services to another bank (the "respondent bank"). Large international banks typically act as correspondents for thousands of other banks around the world. Respondent banks may be provided with a wide range of services, including cash management (e.g. interest-bearing accounts in a variety of currencies), international wire transfers, cheque clearing, payable-through accounts and foreign exchange services;

“Customer due diligence” means a process which involves establishing the identity of a client, the identity of the client’s beneficial owners in respect of legal persons and monitoring all transactions of the client against the client’s profile;

“De-risking” refers to financial institutions exiting relationships with and closing the accounts of clients considered “high risk.” The FATF understands this term to mean situations where financial institutions terminate or restrict business relationships with entire countries or classes of customers in order to avoid, rather than manage, risks in line with the FATF’s risk-based approach (RBA).

“Enhanced customer due diligence” means doing more than the basic customer due diligence measures mentioned above and includes, amongst others, taking measures (as required by the AI) as to identify, as far as reasonably possible, the source of wealth/income, funds and any other assets of the client or beneficial owners whose activities may pose a risk of ML, TF or PF;

“Establish identity” means a two tier process consisting of ascertainment or collecting of certain identification information, and verification of some of the information against reliable documentation or information;

"FATF" means the Financial Action Task Force;

“FIA” also refers to the Financial Intelligence Act, 2012 (Act No. 13 of 2012) as amended; (also referred to as the Act)

“FIC” means the Financial Intelligence Centre as created by section 7 of the FIA;

“Financial inclusion” refers to the provision of accessible, usable, and affordable financial services either through the formal or informal financial sector, to underserved populations.

“Money or value transfer service (MVTS)” These are Authorised Dealers with Limited Authority (ADLAs), as provided for by the Exchange Control Regulations. The services offered includes financial services that involve the acceptance of cash, cheques, other monetary instruments or other means of stored value and the payment of a corresponding sum in cash or other form to a beneficiary by means of a communication, message, transfer, or through a clearing network to which the MVTS provider belongs. Transactions performed by such service providers can involve one or more intermediaries and a final payment to a third party, and may include new payment methods. Sometimes these services have ties to particular geographic regions and are described using a variety of specific terms, including *hawala*, *hundi*, and *fei-chen*.

MVTS providers “offer similar services” as correspondent institutions when they act as intermediaries for other MVTS providers or where an MVTS provider is accessing banking or similar services through the account of another MVTS customer of the bank,

“Respondent institution” means the financial institution that is the direct customer of the correspondent institution,

“SWIFT Relationship Management Application keys (RMA)” is a messaging capability enabling SWIFT members to exchange messages over the network and can create a non-customer relationship in particular cases of cash management, custody, trade finance, exchange of messages with payments and securities markets infrastructure entities, e.g., exchanges depositories.

Correspondent banking services encompass a wide range of services which do not all carry the same level of ML/TF risks. Some correspondent banking services present a

higher ML/FT risk because the correspondent institution processes or executes transactions for its customer's customers.
Hence, the focus of this guidance is correspondent banking relationships that are higher risk, in particular cross-border correspondent banking relationships involving the execution of third party payments.

"TF" means Terrorist Financing

SECTION I: BACKGROUND AND IMPACT OF DE-RISKING

1. Introduction

In recent years, the international community has begun to focus on financial inclusion as part of a broader strategy to reduce poverty, encourage economic development, and promote stability and security. In this Guidance note, the term “financial inclusion” includes the estimated 2.5 billion[1] “unbanked” individuals worldwide who lack access to a formal bank account, the vast majority of whom reside in developing countries. Financial inclusion also applies to “underbanked” communities, where people lack reliable access to or are unable to afford the associated costs of financial services.

The international focus on financial inclusion has coincided with increased attention to Anti-Money Laundering and Countering the Financing of Terrorism and Proliferation (AML/CFT/CPF) frameworks as crucial tools for advancing stability and security objectives and for curbing criminal and violent extremist activity. Naturally, this focus has resulted in increased AML/CFT/CPF regulatory activities of the formal and informal financial sectors, leading to pressure on low-capacity sectors to develop and implement effective AML/CFT/CPF frameworks. Although overly strict approaches to AML/CFT/CPF may inadvertently limit financial access, their respective aims do not inherently conflict. Proportionate and calculated implementation of AML/CFT/CPF measures can help to advance financial inclusion goals by:

a. drawing more economic activity into the formal banking sector; and
b. consequently enhancing transaction monitoring and customer due diligence, which in turn help advance AML/CFT/CPF goals.

However, with risk appetites declining in the wake of the 2008 financial crisis, many financial institutions have opted to exit relationships assessed as being high risk, unprofitable, or simply “complex,” such as those with Authorized Dealers with Limited

[1] Asli Demirgüç-Kunt and Leora Klapper, “Measuring Financial Inclusion: The Global Findex Database,” World Bank Policy Research Working Paper 6025, April 2012, 2. http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-6025 (Subscription required)

Authority (ADLAs[2]), foreign embassies, international charities, and correspondent banks. Closures of these entities' bank accounts affect financial access for the individuals and populations those businesses serve. ADLAs and other financial service providers, often hold accounts with formal financial institutions (banks), which allow them to perform transactions and serve as an access point and gateway for their traditionally underserved client bases. Financial institutions in developing economies such as Namibia often rely on correspondent banking relationships to provide access to the global financial system and underpin trade finance.

This Guidance note provides recommendations to relevant supervisory bodies and financial institutions (especially banks) in the financial sector.

2. Scope and application

This Guidance Note is applicable to:

a. financial Regulatory and Supervisory bodies;
b. relevant Accountable and Reporting Institutions as set out in Schedules 1 and 3 of the Act [as stated in section (2)1 of the Act]; and
c. customers/consumers of financial services.

It contains the FIC's position and guidance on De-risking in the AML/CFT/CPF space and it is issued in terms of section 9 (h) of the FIA 2012.

3. Commencement

This Guidance Note shall come into effect on 10 July 2017.

[2] Also referred to as Money Service Businesses (MSBs) and may include "alternative money transfer services"

4. Challenges presented by de-risking

The FIC, in keeping with international best practices, continues to emphasize that the practice of de-risking in Namibia is not in line with international guidelines, and in fact is a misapplication of the risk-based approach. The FIA advocates for a risk based approach. However, the FIC does recognise that in the absence of clear instructions or an incentive to accord financial services to certain clients, considerations of account closures are growing in the Namibian financial sectors. Locally, the banks stand out as the sector, which has indicated reasons for considering account closures or de-risking. These closures can have significant humanitarian, economic, political and security implications, possibly leading to further isolating communities from the national and ultimately global financial system. Amongst others, this has the potential of facilitating the development of parallel underground "shadow markets" or "underground banking systems".

Unfortunately, little empirical data is available about the extent and nature of the client relationships exited and the decision-making processes of financial institutions. This presents challenges to assessing the scale and scope of the problem, identifying vulnerable communities affected by the reduction in services, and developing effective responses. Nevertheless, there are a few studies that have endeavoured to illuminate a number of existing trends and themes relating to the issue, in the process providing some insight into likely factors behind de-risking practices. A study by Durner and Shetret (2015)[3] found, amongst others, that:

a. The **goals of financial inclusion**, and Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT), are not inherently in conflict; however, tensions do emerge in practice. Overly restrictive AML/CFT measures may negatively affect access to financial services and lead to adverse humanitarian, social, economic and security implications;

[3] T. Durner and L. Shetret., Understanding bank de-risking and its effects on financial inclusion, an exploratory study. The Global Center on Cooperative Security. Published by Oxfam GB for Oxfam International under ISBN 978-1-78077-982-9 in November 2015. Oxfam GB, Oxfam House, John Smith Drive, Cowley, Oxford, OX4 2JY, UK.

b. **Increased vulnerability:** Rather than reducing risk in the global financial sector, de-risking actually contributes to increased vulnerability by pushing high-risk clients to smaller financial institutions that may lack adequate AML/CFT capacity, or even out of the formal financial sector altogether;

c. A **lack of empirical data** about the extent and nature of the client relationships being exited and the decision-making processes of financial institutions impedes an assessment of the scale and scope of the problem as well as the development of effective responses;

d. De-risking represents a **market failure**. All invested stakeholders (banks, regulators, and bank customers and clients) appear to be acting rationally and in their own best interest, but in so doing have created unintended consequences for financial inclusion goals. In such clear instances of market failure, either government or the public sector must intervene to re-align market factors, either through incentive programs or through enhanced regulatory guidance;

e. **Regulatory shortcomings:** Regulatory authorities have been unable to keep up with prevailing market trends in the area of de-risking;

f. **Structural and systemic shortcomings:** Policymakers, regulators, banks, and other stakeholders have not shown the necessary accountability and leadership to address de-risking from a structural and systemic position. The ambiguity of regulatory frameworks, coupled with a lack of empirical information about de-risking criteria, has allowed responsibility for addressing the problem to shift continually among stakeholders. De-banked customers are left without clear expectations and unable to anticipate and protect themselves against impending account closures;

g. **Poor communication (working in silos):** Communication among relevant stakeholders is improving, but it is still limited at practical levels, which results in information stovepipes and *siloed*, ad hoc efforts to address the issue across institutions, departments, industries, and jurisdictions that do not adequately and comprehensively address market factors; and

h. **Reputational risks and defeating financial inclusion:** Already suffering reputational harm following the 2008 financial crisis, financial institutions incur additional reputational damage due to AML/CFT enforcement actions. However, de-risking also has public relations repercussions, since financial institutions are seen as cutting off crucial funds to vulnerable populations. There may also be the potential for reframing the issue as one of corporate social responsibility and for highlighting the potential "reputational returns" of continuing to cater to underserved communities.

4.1 Increased compliance costs and pressures

The FIC takes cognisance of the performance pressures and organizational expectations AML/CFT/CPF compliance functions could find themselves in.

A 2014 KPMG Global Anti-Money Laundering Survey[4], showed that 78 percent of compliance professionals in top global banks reported increases in the total investment in AML compliance, with 22 percent of those respondents indicating an increase of 50 percent during the three-year period from 2011 to 2014. Translating that into concrete expenditures, HSBC spent USD800 million on its compliance and risk management program in 2014, an increase of USD200 million from the previous year. Australian investment bank Macquarie told investors that its direct compliance costs had tripled over the past three years, to nearly USD250 million as of 2014.

At Standard Chartered, regulatory costs are adding one to two percent to annual costs, totalling approximately USD100–200 million each year. The bank has also doubled the number of staff in its financial crime unit and increased legal compliance staff by 30

[4] Survey results obtained from the publication by: T. Durner and L. Shetret., Understanding Bank De-risking and its effects on financial inclusion, an Exploratory Study. The Global Center on Cooperative Security, November 2015

percent. Although these sums may not be staggering for large institutions with multi-billion-dollar annual profits, they are often cited as a key factor in the decision to de-bank clients as rising compliance costs further cut into the profitability of certain customer bases.

According to the KPMG survey, 63 percent of respondents felt regulators should provide more guidance on compliance measures, and 43 percent sought a stronger relationship with regulators. In the Middle East and Africa, 56 percent of KPMG respondents stated they would like to see increasing international cooperation to facilitate consistency of regulatory approaches. Ultimately, the cost of regulatory compliance may be shifted to customers in the form of higher fees, restricted credit, and a reduction in available services and products. For low-income individuals and low-profit margin businesses that are unable to absorb these additional fee structures, this cost-shifting may result in the effective discontinuation of services and exclusion from the financial sector.

SECTION II: GUIDANCE ON DE-RISKING

This section avails guidance on measures that may be considered to enhance the effective implementation of AML/CFT/CPF controls when faced with de-risking considerations.

5. The position of the Financial Action Task Force (FATF)

The FATF has recognized the importance of balancing AML/CFT/CPF with financial inclusion goals, and it issued revised guidance in 2013 to assist countries in developing policies that support these mutually reinforcing goals.

In October 2014, the FATF raised the issue of de-risking at its triannual Plenary Session. In the resulting media advisory, it said:

'De-risking' should never be an excuse for a bank to avoid implementing a risk-based approach, in line with the FATF standards. The FATF Recommendations only require

financial institutions to terminate customer relationships, on a case-by-case basis, where the ML, TF and PF risks cannot be mitigated. This is fully in line with AML/CFT/CPF objectives. What is not in line with the FATF standards is the wholesale cutting loose of entire classes of customer, without taking into account, seriously and comprehensively, their level of risk or risk mitigation measures for individual customers within a particular sector.

The risk-based approach should be the cornerstone of an effective AML/CFT/CPF system, and is essential to properly managing risks. The FATF expects financial institutions to identify, assess and understand their ML/TF and PF risks and take commensurate measures in order to mitigate them. This does not imply a 'zero failure' approach.

5.1 Correspondent Banking Relationships (CBRs)

This section highlights the FIC's position with regard to the objectives of section 25 of the FIA.

Correspondent banking services are provided in three main ways. First, in the most traditional form of correspondent banking, a respondent bank enters into an agreement with the correspondent bank to execute payments on behalf of the respondent bank and its customers. Second, *"nested"* correspondent banking refers to the use of a bank's correspondent relationship by several respondent banks. Third, *payable-through accounts*, also known as *"pass-through"* or *"pass-by"* accounts, are similar to nested correspondent banking, but in the case of these accounts, the respondent bank allows its customers to access the correspondent account directly to conduct business on their own behalf.

The correspondent institution generally does not have direct business relationships with the customers of the respondent institution, unless it provides *payable-through-account* services. Those respondents' customers may be individuals, corporations or financial services firms. In addition to the processing of third-party payments, a correspondent institution may also provide other services to the respondent institution, such as trade-finance related services, cash clearing, liquidity management and short-term borrowing, foreign exchange or investment in a particular currency.

Correspondent banking services encompass a wide range of services which do not all carry the same level of ML/TF/PF risks. Some correspondent banking services (CBRs) present a higher ML/TF/PF risk because the correspondent institution processes or executes transactions for its customer's customers. Hence, the focus of this document is on CBRs that are higher risk, in particular cross-border CBRs, the execution of third party payments.

5.1.1 CBR De-risking: African realities

Based on responses received from the banking sector, on a de-risking questionnaire for ESAAMLG[5], the FIC is not aware of any local withdrawal of CBRs. The FIC is however of the view that Namibia as a country, the central bank and the banking sector can learn from the notable withdrawals on the Africa continent.

In Africa, CBR withdrawal has occurred, for example in Liberia, while problems with banknote supply have surfaced in Angola. In Botswana, concern about compliance with AML/CFT/CPF regulations has led some correspondent banks to close their accounts at the central bank, limiting the range of counterparties available for foreign exchange transactions and investment operations[6]).

a. Liberia has experienced significant loss of CBRs

The IMF staff discussion note further states that global banks have terminated 36 out of 75 CBRs in Liberia between 2013 and mid-2016, citing the country's risk rating,

[5] The Eastern and Southern African Anti-Money Laundering Group (ESAAMLG) conducted a study on de-risking. Questionnaire responses availed by local financial institutions were considered by the FIC when drafting this document.
[6] The International Monetary Fund (IMF). Prepared by M. Erbenová, Y. Liu, N. Kyriakos-Saad, A. López-Mejía, G. Gasha, E. Mathias, M. Norat, F. Fernando, and Y. Almeida. A staff discussion note - The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action, June 2016

AML/CFT/CPF concerns, low volumes of transactions, and their lack of physical presence in the country.

All Liberian banks have lost at least one CBR, with the most affected bank losing 78 percent of these relationships. With CBRs accounting for one-third of interbank activity in the country and about 60 percent of banks' income being sourced from non-interest revenue, loss of CBRs is affecting margins, particularly through lower trade financing. Seeking alternatives in other jurisdictions is costly, depressing profits further, and could affect transparency and efficiency, and limit the central bank's oversight of the transactions. As a result, processing U.S. dollar checks is now lengthier and costlier, with one major bank indicating a cost of USD 150 per check. In addition, a major Western bank severed its euro CBR with the Central Bank of Liberia in March 2014.

b. Angola has also been adversely affected by the loss of U.S. dollar CBRs

The IMF staff discussion note further states that Angola has been adversely affected by the loss of U.S. dollar CBRs. In December 2015, the only supplier of U.S. dollar bank notes to Angola discontinued this service. Another large global bank withdrew U.S. dollar CBRs with Angolan banks, while retaining clearing of the U.S. dollar payments for the central bank of Angola (BNA), as well as local kwanza business. A European bank stopped clearing customer payments in U.S. dollar two months later, but continued to provide letters of credit. As a result, a single European bank is now the sole provider of U.S. dollar CBRs to Angolan banks. Furthermore, only two Angolan banks have direct access to U.S. dollar CBRs. Other Angolan banks are offering U.S. dollar service payments through European banks, resulting in higher costs.

BNA interventions in the foreign exchange market are now primarily in euros with many external trade transactions increasingly invoiced in euros. Bank customers have experienced increase in transaction costs as a result. The study further says that the loss of U.S. dollar CBRs could further weaken the financial system in a country already struggling with the macroeconomic impact of lower oil prices, weak profitability and high levels of non-performing loans. Large firms that need access to U.S. dollars are migrating to the two remaining Angolan banks with U.S. dollar CBRs, putting pressure on the incomes of small and medium-sized Angolan banks. Settlement of international credit and debit cards, and cash management have been particularly affected. However, two banks with a specific investment banking, trade finance and credit card business model have sufficient scale in these activities to transact in U.S. dollars separately with European banks and other global counterparties without resorting to U.S. dollar CBRs.

c. Guinea has likewise experienced a loss of CBRs

Some 20 accounts of the central bank with seven foreign banks have been closed since 2009, with most of the closings concentrated during 2013-15. A survey conducted by the country's central bank indicates that all major banks in the country have suffered closures of CBRs with banks in the United States of America, Europe, and South Africa. As a result of these closures, some banks, including the central bank, have reported a slowdown in their international trade operations. In response to the closures, the study further found that banks envision using the services of their parent companies and branches abroad to conduct international financial transactions.

5.1.2 Enhancing CBR risk mitigation

a. Position on Know-Your-Customer's-Customer (KYCC)

In June 2015, the FATF issued a public statement[7] to clarify that, when establishing CBRs, correspondent institutions are required to perform customer due diligence (CDD) on the respondent institution, and gather sufficient information about the respondent institution to understand its business, reputation and the quality of its supervision, including whether it has been subject to a ML/TF/PF investigation or regulatory action, and to assess the respondent institution's AML/CFT/CPF controls. It was clarified that the FATF Recommendations *do not* require correspondent institutions to perform CDD on the customers of their respondent institutions when establishing CBRs or in the course of the relationship.

Analytical work undertaken so far by different bodies, including the FATF[8], shows that de-risking is a complex issue driven by various considerations including: profitability; reputational and liability risks; changes in banks' financial risk appetites; the amount of

[7] See FATF (2015), Drivers for "de-risking" go beyond anti-money laundering / terrorist financing www.fatf-gafi.org/publications/fatfrecommendations/documents/derisking-goes-beyond-amlcft.html.
[8] FATF Guidance on Correspondent Banking Services, October 2016: The FATF circulated a questionnaire to banks and MVTS in late 2015 to gather information from the private sector which helped to form the basis of this guidance.

financial penalties imposed by supervisory and law enforcement authorities, increased compliance costs associated with implementing conflicting regulatory requirements, including AML/CFT/CPF and confusion caused by the term Know-Your-Customer's-Customer (KYCC). A recent survey[9] also shows that in some cases, banks will exit the relationship solely on the basis of profits ("de-marketing"), irrespective of the risk context and of market circumstances.

The term KYCC has created a lot of confusion. To clarify, the FATF Recommendations *do not* require financial institutions to conduct customer due diligence on the customers of their customer (i.e., each individual customer).

In a CBR, the correspondent institution will monitor the respondent institution's transactions with a view to detecting any changes in the respondent institution's risk profile or implementation of risk mitigation measures (i.e. compliance with AML/CFT/CPF measures and applicable targeted financial sanctions), any unusual activity or transaction on the part of the respondent, or any potential deviations from the agreed terms of the arrangements governing the correspondent relationship. In practice, where such concerns are detected, the FATF guides that the correspondent institution will have to follow up with the respondent institution by making a Request For Information (RFI) on any particular transaction(s), possibly leading to more information being requested on a specific customer or customers of the respondent bank. There is no expectation, intention or requirement for the correspondent institution to conduct customer due diligence on its respondent institution' customers.

5.1.3 Clarity on section 25 of the FIA

Based on queries from the banking sector, the FIC wishes to avail clarity on the following matters:

[9] ACAMS/Dow Jones (2016), Global Anti-Money Laundering Survey Results 2016, http://files.acams.org/pdfs/2016/Dow_Jones_and_ACAMS_Global_Anti-Money_Laundering_Survey_Results_2016.pdf.

a. Responsibility to conduct due diligence

In terms of the FIA, the correspondent banking institution has the responsibility to carry out the necessary due diligence measures, with a view to gaining reasonable assurance that the respondent institution is in a position to mitigate and not expose services of the correspondent banking institution to ML/TF/PF risks. This entails performing due diligence measures outlined in section 25 of the FIA.

The FIC further emphasizes that section 25 applies to Accountable Institutions only in as far as the Accountable Institution is a correspondent bank (i.e. holds a Vostro account for the benefit of a respondent institution).

b. Where Accountable Institution holds Relationship Management Application Keys (RMA's)

Where an Accountable Institution holds RMA's, section 25 of the FIA does not apply to these relationships. Both the FIA and relevant FATF guidance specifically ring fences the CBR obligations to the ongoing relationship between a Corresponding and Responding Institution. Therefore, it does not include the one-off transactions or mere exchange of SWIFT RMAs in the context of non-customer relationships, but rather, is characterized by its ongoing, repetitive nature.

c. FIC expectations on Accountable Institutions' obligations regarding inter-group relationships or any correspondent banking relationships which are not cross border in nature.

The FIC re-iterates the FIA and FATF position which encourages Accountable Institutions to adopt a risk based approach, in all circumstances, without prejudice to the provisions of the FIA and other similar FIC guidance availed. There is no single solution which can be practically suitable to each and every situation presented in each relationship an

Accountable Institution may find itself in. The essence of this section is to re-emphasize the need to strike a balance between:

- the responsibility to effectively management ML/TF/PF risks; whilst
- accepting that other institutions (non-cross border), may not be explicitly required by the FIA to take certain AML/CFT/CPF measures.

The above provides practical risk mitigation challenges as the Accountable Institution is expected to promote sound business practices with due consideration to AML/CFT/CPF obligations.

The following examples are worth noting:

a. **Inter group relations** in which subsidiaries have business relationships. Some major financial institutions are part of a group of companies. ML/TF/PF risk exposure and general risk mitigation levels may differ across institutions in a group of companies.

   An Accountable Institution could find itself unable to gain reasonable assurance that its sister company (or fellow subsidiary) has adequate and effective measures to mitigate ML/TF/PF risks, thereby unduly exposing it to such risks, if there is a business relationship. The FIC position is that such concerned Accountable Institution remains with a duty to ensure that its systems are not abused in the advancement of ML/TF/PF activities. It therefore goes without saying that the nature of such a relationship should guide the concerned Accountable Institution's measures to protect itself from undue ML/TF/PF risk exposure. The Accountable Institution has to gain assurance by, amongst others, evaluating the risk exposure and devising the best possible mechanism(s) to mitigate such risks. The nature of such a relationship could be used to guide the approach taken to mitigate risks;

b. Corresponding banking relationships **that are not cross border** in nature: Local institutions do have relationships with each other, mostly by virtue of the nature of services they avail to clients. Section 25 does not apply to these relationships as explained herein. However, the FIC still maintains that - without prejudice to the

FIA and relevant FIC guidance availed, the responsibility to ensure that an Accountable Institution's systems are not unduly exposed to ML/TF/PF risks, owing to such other business relationship cannot be shifted to another institution entirely. In practice, this means the concerned Accountable Institution has to gain reasonable assurance by, amongst others, evaluating the ML/TF/PF risk exposure emanating from such non-cross border relationships and devising the best possible mechanism(s) to mitigate such risks.

5.2 The FIA and de-risking clients

This section presents the FIC's position on certain FIA provisions, which relate to de-risking or freezing of client accounts (ceasing to avail services to clients).

The FIC understands challenges experienced by Accountable and Reporting Institutions in terms of ensuring adequate CDD/KYC, on all its clients. Accountable Institutions have indicated there are significant number of clients whose CDD/KYC information is inadequate, despite efforts to obtain such required information. Accountable and Reporting Institutions are expected to manage the ML/TF/PF risks presented by such clients, even when the said clients are not adequately identified. Institutions have also indicated that de-risking is only considered when all other efforts to attain such required CDD/KYC have failed. The FIC understands the practical challenges presented by these circumstances.

As a starting point, the FIC remains entirely opposed to mere de-risking without due consideration to risk exposure of each client or set of transactions. The Risk based approach is ideal as it entails a case-by-case consideration of relevant issues (specific client/service/internal vulnerability etc). Blanket de-risking of a class of customers/relationships is not encouraged by the FIC and should only be considered, as a last resort, should all other alternatives fail and the Accountable Institution remains convinced that this is the most suitable alternative to take in managing ML/TF/PF risks.

5.2.1 Freezing of accounts owing to inadequate CDD/KYC

Application of sections 22 (2) and (3) of the FIA 2012, along with Regulation 5 (1) and (2) and the overall risk based approach.

Section 22 (2) of the FIA provides that if an Accountable or Reporting Institution is unable, within a reasonable period to establish to its reasonable satisfaction, the identity of any person as required, it may not conclude any further transaction in the course of that business relationship and must immediately file a suspicious activity report. This should be considered with section 22 (3) which further guides that when the identity of the person referred to in section 22 (2) is subsequently established, further transactions may only be concluded after the FIC has been informed of the identity of that person.

Section 5 (1) states that for the purpose of establishing the identity of a client under sections 21 or 22 of the Act, an Accountable or Reporting Institution must comply with Regulations 6, 7, 8, 9, 11, 12, 13, 14 and 20, relating to ascertainment and verification of identity.

The FIC emphasize that Regulation 5 does not expect Accountable or Reporting Institutions to resort to de-risking, account freezing or closures, as a first alternative, in cases of failure to properly identify clients (CDD/KYC). The Regulation stipulates that, to the extent possible, Accountable or Reporting Institutions take such reasonable steps to ascertain or verify client's identity and obtain all other related information.

If such steps fail, the institutions should immediately give written notice to the FIC explaining, amongst others:

a. such impracticability or impossibility;
b. the alternative measures or steps used to identify or verify such clients; and
c. the proposed way forward and potential implications of such proposed measures, if any.

It should be noted that the FIC may request for any other or additional information it deems necessary that may inform its approach in this regard.

After having notified the FIC, the Accountable or Reporting Institutions may not open such accounts, nor commence the business relationship or perform transactions or terminate the business relationship, except if otherwise directed by the FIC. This therefore means that engagements with the FIC should enable the FIC to guide the Accountable or Reporting Institutions on the way forward.

At this opportunity, depending on the nature of circumstances at hand, it is also advisable that the Accountable or Reporting Institutions considers filing a suspicious transaction or activity report, except if otherwise directed by the FIC.

It should be noted that the “the freezing of accounts” in these Regulations (e.g 5) do not refer to the freezing as envisaged in section 42 of the FIA 2012, which is usually invoked by the Financial Investigations and Analysis Division (FIAD), in relation to potential investigations.
The account freezing referred to herein has to do with Accountable or Reporting Institutions freezing such accounts with the aim of encouraging relevant account holders or clients to engage such institutions in an effort to address noted client due diligence shortcomings. Whenever possible and without prejudicing ML/TF/PF risk mitigation efforts, de-risking or account freezing should be exercised in a manner that encourages affected clients to engage such institutions in order to address relevant client due diligence shortcomings.

6. Additional considerations for financial institutions

This section highlights general considerations to help enhance CDD measures, thereby reducing the scale of de-risking:

a. **Review and revise enterprise-wide KYC policies and procedures** to better identify, mitigate, and manage risk. The periodical reviews should be aligned to changes in risk behaviour or exposure. It is helpful to consider previous FIC findings, impacts and recommendations documented in prior FIA Compliance Assessment Reports (if any). Where none such reports exists, feel free to engage the FIC for guidance in the creation of such control frameworks;

b. **Practical client on boarding re-alignment:** Periodically review and fine-tune client on-boarding practices to collect necessary information, while explaining to the client how that information is used and what purpose it serves. Help clients understand why certain information is required;

c. **Control framework and risk exposure:** To the extent possible, continue to invest resources in compliance departments, but assure adequate staffing and resourcing of operational and technological teams, who are often tasked with the practical implementation of compliance directives. The objective is to address mismatches between overall risk exposure and relevant control framework effectiveness (also see below);

d. **The use of Technology:** Engage with and provide adequate resources to technological stakeholders to explore innovative approaches to reducing compliance burdens and improving transactions monitoring;

e. **Enhance financial inclusion:** Consider and harness the reputational return of demonstrated corporate social responsibility campaigns focused on the extension of financial services, particularly to underserved communities and individuals;

f. **Enhanced monitoring:** Mitigate risk of insufficient CDD by customer agencies by implementing enhanced transaction monitoring processes and technologies;

g. **Information sharing and best practices:** Consider sharing information with other relevant stakeholders on how role players are handling CDD/KYC inadequacies, in an effort to learn from possible best practices; and

h. **Engage key stakeholders** in view of the ML/TF/PF risks the present: Consider engaging other stakeholders such as Money Service Business (MSB) associations,

associations of Motor Vehicle Dealers, Estate Agencies Boards (meetings in an observer capacity), to enhance sectoral understanding on AML/CFT/CPF matters and build trust. Many sectors make use of financial systems, such as banking services and the conduct of such sectors can expose such financial services to potential ML/TF/PF risks.

7. General

This Guidance Note uses plain language to explain the FIC's position on the emerging trend of de-risking, account freezing and similar type of conduct that aimed at eliminating risks. This document is intended to explain, but not replace, the position of the Act and Regulations. The FIC therefore affirms that this guidance is issued without prejudice to other existing guidance or work in the identified area.

The contents of this Guidance Note shall be reviewed from time to time. The affected sectors will be notified of any aspect that may necessitate revoking or amending any guidance set out in this Guidance Note.

If you have any comments or suggestions to help improve this Guidance Note, please send your comments to the mailing address provided below.

8. How to contact the FIC

All Correspondence and enquiries must be directed to:

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