BSG own initiative paper

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BANKING STAKEHOLDER GROUP

BSG own-initiative advice: 'de-risking'

Context

A core part of the international anti-money laundering regime is the obligation on entities in the regulated sector to know their clients and manage the associated money-laundering/terrorist financing risks.

This approach can lead to a tension between customers' requirements for access to financial services, and financial institutions' concerns about what money-laundering risks they may be exposed to and how to manage them. It can also create the potential for tension between different policy objectives as authorities seek on the one hand to ensure that AML risks are managed while also ensuring fair treatment of customers and financial inclusion. Where financial institutions provide services to potential competitors, competition considerations can be relevant too.

'De-risking' is a phenomenon previously described by the FATF, the international standard-setter, as 'the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risk in line with the FATF's risk-based approach'.[1]

In May 2020, before the current BSG was established, EBA launched a call for input on de-risking.[2] The BSG has reflected on the responses to EBA's call for input, considering separately several distinct categories of customer EBA had identified from the responses that were concerned about the impact of de-risking and in this own-initiative advice sought to identify additional steps that EBA could take to reduce the likelihood and impact of de-risking for different categories of customer. The response has also been informed by the FATF's recent stocktake on unintended consequences of AML standards.[3]

Since we began our reflection, EBA has published an Opinion and annexed report on de-risking, following on from the Call for Input.[4] We welcome EBA's publication of the Opinion and Report and the call in the Opinion for clarification of the relationship between different Level 1 measures which,

[1] *FATF clarifies risk-based approach: case-by-case, not wholesale de-risking*, October 2014.

[2] *EBA calls for input to understand impact of de-risking on financial institutions and customers*, 15 June 2020.

[3] *High-level Synopsis of the Stocktake of the Unintended Consequences of the FATF Standards*, 27 October 2021. [FATF 2021]

[4] *Opinion of the European Banking Authority on 'de-risking'*, EBA/Op/2022/01, 5 January 2022.

as we flagged in our Own Initiative Report on AML Strategy,[5] create difficulties in the implementation of effective AML controls. We also welcome EBA's publication of initiatives taken by some competent authorities to address problems related to de-risking. In this own-initiative report, we offer further reflections on the drivers of de-risking and on additional practical steps EBA could take to support the implementation of appropriate AML risk-management without the negative impacts which arise from unwarranted de-risking.

General Principles

We have focused in this advice on each category of customer separately, given the different nature of the issues raised, and we have also considered the extent to which certain groups were likely to have been in a position to respond to EBA's call for input.

Our recommendations start from the assumption that there may be individual customers whose behaviour or lack of willingness to engage with procedures in place to counter money laundering may mean that the risk associated with that customer cannot be accurately assessed or effectively managed. Our concern is to ensure that any such decision is based on an assessment of an individual customer, not a whole category of customer.

We have also been aware that some financial institutions play multiple roles in relation to AML controls. For example, a payment service provider (PSPs) authorised under PSD II may be both a customer of a bank and potentially impacted by that bank's 'de-risking', and it will also be subject to AML requirements in its own business with the potential to 'de-risk' its own customers.

We have taken advantage of the BSG composition bringing together different stakeholder categories, including banks, PSPs, consumer and user representatives, to focus on areas where there is a consensus that progress can be made, and we have concentrated our recommendations for action on areas that are within EBA's current mandate.

Payment service providers

Why is de-risking an issue

A particular bank can decide whether facilitating access to banking services (opening or maintaining a bank account) for a non-bank payment provider is within its risk-appetite, which could translate into a refusal of service or requests for changes in the operating model.

Several institutions have tried to study the de-risking phenomenon e.g. FATF. However, the lack of solutions so far may drive financial transactions into less/non-regulated channels, reducing transparency of financial flows and creating financial exclusion, thereby increasing exposure to money laundering and terrorist financing (ML/TF) risks. Often the more marginalised or disenfranchised parts of society are deemed to be potentially more risky - as reflected in the most recent supranational risk assessment by the European Commission. This leads to extra compliance burdens, in turn excluding

[5] *AML Strategy*. BSG 2021 026, April 2021.

businesses from conducting their business by being cut from bank and correspondence banking services.

De-risking has also implications for the entire market. It leads to ineffective mitigation of ML/TF. Transparency helps to build trust but strong communication is also essential in tackling the inherent risk of money laundering and fraud. If banks close their doors and are not willing to have an open dialogue about trends, controls and solutions, they are not contributing to the effective prevention of ML/TF.

De-risking drives prices up since prices need to be negotiated. If a payment service provider gets de-banked and must find a new partner, this requires ongoing resources within the company and often means a more costly deal. De-risking also disrupts consumers' access to products. If a product in one Member State relies on a main banking partner and a back-up partner, if both of those banks decide to de-risk at one time, this is a risk to operational continuity.

De-risking also contributes to restricting access to provision of business bank accounts. Restricted market access for a subset of consumers is, in effect, a market failure. This drives ineffective competition between PSPs and incumbents, and may also lead to the concentration of risk.

Drivers of de-risking

The FATF's approach to de-risking requires financial institutions to identify, assess and understand their money laundering and terrorist financing risks, and implement AML/CFT measures that are commensurate with the risks identified.

When establishing relationships with non-bank PSPs, banks are required to perform normal customer due diligence on these PSPs. Additionally, banks are required to gather sufficient information about the non-bank PSP to understand its business, reputation and the quality of its supervision, including whether it has been subject to a money laundering or terrorist financing investigation or regulatory action, and to assess the PSPs AML/CFT controls.

We understand the tensions that banks face between the pressure to de-risk versus the pressure to be inclusive on access. On the one hand, we believe that banks should apply the KYC rules proportionately with the respective ML/TF risk. Banks should not de-risk the whole PSP sector but rather adopt a case-by-case approach. On the other hand, non-bank PSPs should provide information about their business models and AML risk profile/compliance programs to banks.

There are major communication gaps between banks and non-bank PSPs and the dialogue is often limited. The lack of a safe space for banks and non-bank PSPs to exchange information on typologies and ML/TF risks can hinder an intelligence-led approach to financial crime risks.

Policy recommendations

The United Kingdom has developed specific Guidelines to provide the banking sector with clear rules on how to provide access to the non-bank PSPs. This includes a dedicated Chapter 16 in the PSD2 Approach document of the UK competent authority which specifies the criteria and procedures banks have to follow under Article 36 of the Payment Services Directive (PSD2). This has significantly reduced

the market impact resulting from de-risking. Similar dialogues have been initiated in some EU Member States and we believe this offers a good model that should be emulated across the EU.

The Belgian Central Bank has issued a helpful statement in this regard. It sets out that credit institutions should only adopt de-risking as an extreme measures only after assessing the circumstances relevant to the particular case and only when other possible ML/TF risk management and mitigation measures are not available, have already been exhausted and/or where a credit institution is unable to properly comply with ML/TF prevention requirements and to manage ML/TF risks when establishing and/or continuing a business relationship with a specific non-bank payment provider.

The EBA could play the role of facilitator at EU level by organizing the dialogue between banks and non-bank PSPs on de-risking and adopting the best practices from the UK and/or Belgium mentioned above.

In the light of the European Commission's proposals for an EU Anti-Money Laundering Authority and a new AML Regulation there is also a real opportunity to move to a more harmonised approach to banking de-risking. This should also give the banking sector more comfort and all involved parties more predictability. A harmonised AML framework should remove much of the reasons for any concerns by banks around the ML/TF implementation by the non-bank payment sector.

We would furthermore invite policymakers to explore any regulatory solutions to de-risking where banks no longer accept non-bank PSPs as clients. Specifically, non-bank PSPs who are able to meet the necessary systems and controls requirements (including AML/CFT requirements) could be permitted to directly hold accounts with the national central bank and allow for the settlement through these central bank accounts.

NGOs and non-profits

Context

A further group indicated as experiencing 'de-risking' in the responses to EBA's call for input was non-governmental organisations (NGOs) and other non-profits. This can be a diverse group, from very small organisations with very limited resource and expertise in finance, to large organisations operating in multiple jurisdictions, some of which may be high-risk from an AML perspective. We understand that similar issues may arise in relation to embassies.

Recommendations

We think there is a role for competent authorities, financial institution trade associations and umbrella organisations for NGOs and other non-profits to educate non-profits about why banks and other financial institutions may require them to provide certain information and may be concerned about aspects of their own operations and practices from an AML perspective and what kind of adjustments may make a bank or other financial institution more comfortable about having them as a customer. One example is the guidance provided by the UK Office of Financial Sanctions Implementation (OFSI)

for charities and NGOs regarding financial sanctions to ensure that they are understood, implemented and enforced. [6]

We further think that there is a role for EBA in facilitating and co-ordinating this educational effort and sharing of experiences between competent authorities, taking as a starting point the experiences of those who responded to the consultation, and in raising awareness with representative bodies at the EU as well as member-state level. We understand that EBA has already taken steps in this area and encourage them to build on this starting point.

There may be an additional role for EBA in facilitating sharing of experience and good practice in relation to the extent to which financial institutions can provide feedback to individual customers without 'tipping off' about AML concerns.

'Accidental Americans'

Context

A further category of respondents who expressed concern in response to EBA's call for input were so-called 'accidental Americans'. These are EU citizens who have some connection with the USA sufficient for them to be potentially within the scope of the American 'FATCA' legislation, which brings very significant reporting obligations for financial institutions along with the risk of very significant financial penalties if obligations are not met.

In some cases, difficulties may arise for customers because the financial institution does not want to have any connection at all with American clients, so as not to have obligations under FATCA. In other cases, customers may not be able to provide the expected information and so the financial institution may not consider that it could meet its FATCA obligations in relation to that customer. For example, an individual born in the USA might have American citizenship but, having never lived there, not have a social security number. Some customers try to address the issue by giving up their American citizenship but this may only be done for certain limited grounds and anecdotally is very hard to do.

We recognise that this is not a new issue and that challenges have arisen since FATCA came into force. However, the impact on those individuals affected can be extreme, effectively cutting EU citizens off from access to EU financial services. We therefore think it is right to continue efforts to minimise the impact of FATCA on EU citizens who are also 'accidental Americans'.

Recommendations

We would therefore suggest the following steps be taken:

- EBA should contact all the individual 'Accidental Americans' who responded to the consultation to find out exactly what their situation is, at what point they encountered difficulties and in relation to which services at which institutions. This exercise would also aim

[6] See *OFSI updates charity sector guidance*, November 2021; Office of Financial Sanctions Implementation (OFSI), *Charity sector guidance: Financial Sanctions guidance for charities and other non-governmental organisations (NGOs)*, updated November 2021; and OFSI, *UK Financial Sanctions: General Guidance*.

to find examples where customers were eventually able to access the services they needed and how, and from which institutions. The aim of doing this is to build an 'evidence base' from a consumer perspective, recognising that this may not be a statistically relevant sample.

- EBA to convene supervisory convergence work to explore situations where 'Accidental Americans' have been able to access banking services and how institutions have enabled this, including in more complex situations. This could also involve seeking input from financial institutions on:

    - the FATCA and KYC compliance challenges in relation to US customers, with a particular focus on so-called 'Accidental American' customers;

    - the risk they may incur of being considered in significant non-compliance with FATCA; and

    - whether they apply a risk-based approach and otherwise how they manage this situation.

- EBA should facilitate the transmission of practical solutions to cases (e.g. where an individual does not have a social security number) to competent authorities and financial institutions and clarify whether it is permissible for a financial institution established in the EU to refuse to provide services to an EU citizen on the basis that they are also American. We would argue that it should not be.

- EBA to present matters on which there do not appear to be solutions to the European Commission to raise with the US authorities in the context of the Transatlantic Dialogue.

Financially excluded and vulnerable groups

Context

Although EBA did receive some responses from non-EU citizens who considered they had suffered de-risking, we think it is important to note that many who are vulnerable to de-risking as a result of factors which also make them vulnerable to wider financial exclusion, such as a lack of standard means of identification or permanent address, are highly unlikely to have responded to the consultation. Evidence about customers in such groups can also be difficult for consumer organisations to obtain. We think it is therefore important not to conclude that de-risking is not a problem for people at risk of financial exclusion more widely just because this was not the focus of responses to the call for input.

We note that FATF has recently acknowledged that there may be unintended consequences from its requirements which exacerbate financial exclusion.[7] Some respondents to FATF's consultation drew attention to the lack of incentives for supervisory authorities and financial institutions to use tools that should already be available within FATF's risk-based approach, such as simplified due diligence, to enable financial inclusion.[8] This is because use of SDD is more likely to be criticized if there is any doubt

[7] See FATF 2021.

[8] See for example *Assessing the Financial Action Task Force's Impact on Digital Financial Inclusion*, Royal United Services Institute for Defence and Security Studies, June 2021.

about the AML basis for it, than acknowledged as a way of enabling financial inclusion. In addition to being desirable in itself, financial inclusion can actually improve the system's overall understanding of and ability to manage AML risk if it reduces the need for those who would otherwise be excluded to use unregulated service providers. We further note that despite this lack of incentives, there are examples of financial institutions partnering with NGOs to find creative solutions to enable access for those without a permanent address or with non-standard identification.[9] Although both FATF and EBA have provided some relevant guidance in the past, this may need to be either clarified and strengthened, or benefit from being 'translated' through supervisory convergence work.

Recommendations

We therefore recommend that:

- EBA consider carrying out or co-ordinating mystery shopping activity among national competent authorities to explore the access available in practice for those from vulnerable or excluded groups or with non-standard identification and on the application of simplified due diligence in eligible situations.

- EBA invite NCAs to share examples of innovative approaches taken by financial institutions and NGOs to support access to services by potentially excluded or vulnerable consumers including non-EU citizens and those without a permanent address.

- EBA give explicit consideration in its forthcoming guidelines on e-ID to ensuring that digitisation of on-boarding and CDD does not lead to further exclusion and de-risking of those who are less technologically literate or enabled.

- EBA consider, with appropriate input from NCAs and other stakeholders, and in liaison with international counterparts through FATF, situations where simplified CDD should be expected or required rather than optional to better balance the AML and financial inclusion objectives.

[9] See for example: https://www.about.hsbc.co.uk/news-and-media/hsbc-uk-doubles-availability-of-accounts-to-help-homeless-people-get-access-to-banking