FSB FINANCIAL STABILITY BOARD

Stocktake of remittance service providers' access to banking services

16 March 2018

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Table of Contents

Foreword iv
Abbreviations vi
Executive summary 7
1. Recommendations to improve the accessibility of banking services to RSPs 9
2. Extent of the problem and possible causes 12
3. Common characteristics and practices associated with the remittance sector 18
4. International standards and oversight of the remittance sector 22
5. The role of innovation 29
6. Remittance-related technical assistance 34

Foreword

As stated in the March 2017 G20 Finance Ministers and Central Bank Governors Baden-Baden communique[1] and July 2017 G20 Leaders' Hamburg Action Plan[2], the Financial Stability Board (FSB) has coordinated work, together with the Financial Action Task Force (FATF) and the Global Partnership for Financial Inclusion (GPFI), to address remittance service providers' (RSPs) access to banking services that are not already being dealt with through existing initiatives. To this end, the FSB has taken stock of past and ongoing initiatives, including through consultations with the private sector, to assess whether there are remaining issues relating to remittance providers' access to banking services, and, if any are identified, evaluate the need for an action plan to address them. If deemed appropriate, the G20 will pursue actions to address any unwarranted barriers identified by the stocktaking in early 2018 and proceed with their implementation thereafter.

To carry out this work, in July 2017 the FSB created a Remittance Task Force, chaired by Matthew Taylor, Director (International), HM Treasury, United Kingdom (UK), that reports to the FSB Correspondent Banking Coordination Group and, in turn, to the FSB Plenary. The Remittance Task Force has 38 members representing 25 jurisdictions (11 of which are non-FSB members) and five international organisations and standard setters.

This report summarises the findings from the stocktake, a high-level roundtable with the industry in Washington DC on 12 October 2017 and subsequent technical meetings in Brussels on the interaction between remittance service providers and banks, and possible innovative solutions, and in Copenhagen on the supervision and oversight of the remittance sector. The report recommends possible actions to improve the availability of banking services to RSPs. It covers:

- The extent of the problem and possible causes;
- The common characteristics and practices within the remittance sector and how these present challenges for remittances firms to access banking services;
- International standards and supervision of the remittance sector – are international standards sufficiently comprehensive and how do supervision and regulation affect banking access;
- How is innovation used in the remittance sector and what role might it play in enabling RSPs to have greater access to banking services; and
- What remittance-related technical assistance (TA) is being provided and where the sector and remittances activities might benefit from additional assistance.

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1 See http://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Topics/Featured/G20/g20-communique.pdf;jsessionid=779553C7CD550227740E9F2D4881EB12?__blob=publicationFile&v=3.

2 See https://www.g20germany.de/Content/DE/_Anlagen/G7_G20/2017-g20-hamburg-action-plan-en.html?nn=2186554.

The FATF uses the term Money or Value Transfer Services (MVTS) to refer to financial services that involve the acceptance of cash, cheques, other monetary instruments or other stores of 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 services can involve one or more intermediaries and a final payment to a third party, and may include any 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.

RSPs for the purposes of the FSB's work and as referred to in this report, are a subset of MVTS providers and are defined as financial institutions that:

- Engage in the transmission of cross-border payments, frequently through the use of agents (with the originator and/or beneficiary typically using cash);
- Are not banks, although the report acknowledges that some banks may also provide remittance services; and
- Are regulated (as opposed to unregulated or informal, since the objective of this work is to improve access to banking of regulated providers).

As can be seen from the FSB's definition of RSPs above, unregulated entities, for example, were not within the scope of its work. When referring specifically to FATF guidance, the report will use MVTS; otherwise, the scope of the report is limited to RSPs.

Abbreviations

AML/CFT	Anti-money laundering / combatting the financing of terrorism
CBRs	Correspondent banking relationships
CDD	Customer Due Diligence
CPMI	Committee on Payments and Market Infrastructures
DLT	Distributed ledger technology
EU	European Union
FATF	Financial Action Task Force
FIUs	Financial Intelligence Units
FSB	Financial Stability Board
GDP	Gross Domestic Product
GPs	General Principles for International Remittance Services
GPFI	Global Partnership for Financial Inclusion
IAMTN	International Association of Money Transfer Networks
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
KYC	Know Your Customer
LEI	Legal Entity Identifier
ML/TF	Money laundering / terrorist financing
MVTS	Money or Value Transfer Services
PAFI	Payment Aspects of Financial Inclusion
PRI	Pakistan Remittance Initiative
RBA	Risk-based Approach
RSPs	Remittance service providers
SIDS	Small island developing states
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TA	Technical assistance
UK	United Kingdom
USD	United States dollar

Executive summary

A decline in the number of correspondent banking relationships remains a source of concern for the international community. The reduction in correspondent banking relationships (CBRs) has had a significant impact on RSPs' ability to access banking services. Further, the impact is particularly acute in those developing countries where remittance flows are a key source of funds for households; in many of these jurisdictions remittances represent a significant percentage of Gross Domestic Product (GDP).

This stocktake identifies a variety of intertwined drivers for the termination of banking services to RSPs, including profitability, the perceived high risk of the remittance sector from an AML/CFT perspective, supervision of RSPs that ranges from active and effective to complete absence and, in some jurisdictions, weak compliance with international standards, particularly those relating to AML/CFT.

Banks frequently characterise the entire remittance sector as high risk. On the one hand, this may be because RSPs' business model frequently includes handling large numbers of cash transactions; sending money to jurisdictions which are considered high-risk (e.g. because of conflict, terrorism, or weak supervision); and business which is conducted through agent networks and on behalf of occasional customers with whom they do not have an ongoing relationship. On the other hand, while many jurisdictions, although certainly not all, have created legal and regulatory frameworks for RSPs that are technically compliant with FATF standards, there appears to be very uneven implementation of the frameworks that, in turn, leads to supervision of the remittance sector that ranges from active and effective to complete absence. Better application of the risk-based approach (RBA) as discussed in the FATF Recommendations[3] and better supervision and oversight of the remittance sector, including communication of supervisory approaches and strategies, are critical actions to mitigate this perception of uniformly high risk on the part of banks.

The international community has supported efforts to reduce remittance costs to end-customers; indeed, they have declined over the past decade and as of the third quarter of 2017, the cost of sending USD 200 was 7.2%.[4] Nevertheless, this remains well above the United Nations' Sustainable Development Goal target of 3%. At the same time however, banks often claim that they derive insufficient profit given the level of risk associated with RSPs. The stocktake considers the supervisory shortfalls that are common across jurisdictions and makes recommendations to enhance supervision that might help give banks greater confidence in their ability to manage the risk of RSPs at an acceptable cost.

The stocktake considers technical solutions that could help to address the drivers of RSPs' reduced access to banking services. The findings not only highlight a number of promising financial technology approaches that could directly address some drivers of so-called "de-risking" (i.e. terminating business relations with whole categories of customers in order to avoid, rather than manage risk), but also identify a number of opportunities where innovation

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[3] See http://www.fatf-gafi.org/media/fatf/documents/reports/Risk-Based-Approach-Banking-Sector.pdf.

[4] See https://remittanceprices.worldbank.org/en.

can be applied to existing tools, including opportunities in the areas of regulation, supervision, compliance and direct government initiatives. However, while these innovations may mitigate some drivers, they are unlikely in the foreseeable future to provide entire solutions that completely address all drivers of de-risking.

Finally, the stocktake considers both TA activities that (1) directly or indirectly benefit remittance markets and (2) either help mitigate the negative effects of the withdrawal of banking services or make it less likely to occur in the first place.

The report includes 19 recommendations in four main areas that, if implemented, may contribute to greater access by banking services by RSPs. The four categories of recommendations are as follows:

- Promoting dialogue and communication between the banking and remittance sectors
- International standards and oversight of the remittance sector
- The use of innovation in the remittance sector and its possible role in enabling RSPs greater access to banking services
- Technical assistance on remittance-related topics

The FSB, FATF, GPFI and International Monetary Fund (IMF)/World Bank will coordinate to monitor take-up of the recommendations and report back to the G20 in July 2019.

1. Recommendations to improve the accessibility of banking services to RSPs

This report includes recommendations in several key areas that, along with brief annotations, are listed below. Further details on each of the recommendations can be found in the relevant section of the report.

In addition to the recommendations and annotations, an authority is identified for each area of recommendations that will be responsible for monitoring actions taken by national authorities, banks and RSPs in response to the recommendations. It is proposed that a report detailing the steps and actions taken with respect to the recommendations be submitted to the G20 Ministers and Central Bank Governors in July 2019.

Recommendation	Responsible authority for monitoring
Promoting dialogue and communication between the banking and remittance sectors	**FSB**

Fostering dialogue between the RSP's and the banking sectors through public initiatives to improve interconnectedness between both sectors. The FSB, GPFI, FATF, IMF and World Bank should continue to facilitate a dialogue among stakeholders to foster a common understanding of issues facing the remittance sector and RSPs' access to banking services.

Promote private sector initiatives to foster dialogue between the remittance and banking sectors. Banks and RSPs could work together to enhance the level of understanding, communication and cooperation between themselves; thereby enabling banks to apply a RBA. The banking sector could, for example, clarify with RSPs their expectations concerning AML/CFT compliance and offer assistance, where appropriate.

Support of mechanisms to standardise, where appropriate, financial communication, including clearing and settlement infrastructures, between the banking and remittance sectors. Cost functions, compliance processes and financial communication (including information sharing) would be improved through technical standardisation and standardisation initiatives such as ISO 20022.

Supporting actions by the remittance sector, such as the development of a code of conduct, to improve the risk perception of the sector by banks. Demonstrating the level of AML/CFT compliance could help to improve perceptions surrounding risk management practices within the sector. An example of this is the code of conduct being developed by the International Association of Money Transfer Networks[5] (IAMTN). The introduction of a private sector certification or periodic independent audits to demonstrate compliance could

[5] The IAMTN is an international organisation representing money transfer industry and payments institutions providing cross-border payments. Founded in 2005, the objective of the organisation is to discuss common challenges and industry initiatives.

be a useful complement to the code as it would strengthen the confidence of correspondent banks in the AML/CFT procedures of RSPs. It is recommended that work on these best practices continue, with a view to pilot it at least at a domestic level.

International standards and oversight of the remittance sector **FATF**

National authorities should implement the FATF standards as they relate to RSPs. In particular, they should: (a) assess the risks associated with RSPs when conducting national risk assessments for money laundering/terrorist financing (ML/TF); (b) ensure that RSPs are licensed or registered, and their agents are either licensed or registered or RSPs are required to maintain current list of their agents; (c) apply a system of risk-based monitoring and inspection of RSPs; and (d) apply criminal and/or administrative sanctions for significant violations of AML/CFT obligations.

National authorities should evaluate and improve, as necessary, coordination and information sharing practices. Effective coordination and information sharing practices among supervisory, financial intelligence, law enforcement and other authorities, responsible for the oversight of RSPs are a critical element of oversight of the remittance sector.

National authorities should publish guidance. National authorities should publish, as necessary, guidance on the RBA and the banking of RSPs, on their regulatory and supervisory expectations for AML/CFT compliance by RSPs, and should consider additional efforts to engage in direct dialogue with the private sector on these issues. Doing so would assist both banks and RSPs to properly implement laws and regulations and in the case of banks, manage the risks associated with RSPs.

National authorities should assess whether their models for the regulation and supervision, as well as inspection of RSPs, are effective and properly include a RBA. If not, authorities should clearly outline what steps they could take to address deficiencies, recognising that this may have an impact on the number of players in the market. Where appropriate national authorities could consider augmenting oversight of the remittance sector with regular reviews by independent parties including external auditors. Doing so would not however, absolve supervisors from their oversight responsibilities.

National authorities could consider programmes that would enable supervisors to collect data necessary to effectively oversee the remittance sector and for both supervisors and RSP principals to monitor and assess the risks associated with agents. National authorities could consider mechanisms that enable them to collect data from RSPs that is necessary for them to properly supervise both the remittance sector as a whole and remittance providers individually. In addition, supervisors and RSPs could require regular reporting on the admission of agents into the remittance sector and that RSPs closely monitor and assess the risks associated with their agents.

The use of innovation in the remittance sector and its possible role in enabling RSPs greater access to banking services **GPFI**

National authorities should consider how the regulatory environment could best support greater innovation. Innovation could be promoted through, for example, the use of sandboxes or innovation hubs, while at the same time managing risk levels and maintaining a healthy and stable financial system.

National authorities could promote new technologies supporting the identification of customers. Technologies such as e-ID and those that facilitate the creation of e-ID platforms as well as access to these platforms by financial institutions (including banks and non-banks, and in general all financial institutions providing remittance services) could help to reduce ML/TF risks.

National authorities should investigate and implement – to the extent feasible within national legislation – ways to facilitate end-users' access to transaction accounts offered by banks as well as non-banks. Access to transaction accounts would increase end-users' freedom of choice and could mitigate their vulnerability to loss of access to cash-based remittance services.

Without introducing a technological bias, national authorities should consider digital solutions when drafting and issuing laws and regulations, in order to make them more resilient to future technological developments.

Without introducing a bias, national authorities could support the development of FinTech firms through enabling legal and regulatory frameworks. In addition to creating a supportive environment for FinTech firms and innovation, the frameworks should ensure that FinTech firms are subject to proportionate and risk-based AML/CFT requirements. Authorities could also identify adequate risk mitigation measures for FinTech products, which would contribute to lowering their risk-profile.

Remittance-related technical assistance (areas of possible focus) **IMF/World Bank**

Technical assistance focused on the strengthening regulation and supervision of RSPs, where necessary. TA providers should prioritise capacity building, consistent with international standards and guidance, such as the General Principles for International Remittance Services[6] (GPs) and FATF standards, to the areas of regulation and supervision where material weaknesses have been identified. These include appropriate licensing procedures; effective risk-based supervision; adequate cooperation between supervisors, including between AML/CFT supervisors and payment systems overseers; and proportionate and deterrent administrative, civil or criminal sanctions in case of non-compliance or illegal provision of services.

Preparing national risk-assessments to determine the level of risk posed by the remittance sector, particularly ML/TF risk.

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[6] See http://www.bis.org/cpmi/publ/d76.pdf.

Reducing the use of cash in remittance flows. TA could be directed at efforts to promote the access to and use of transaction accounts offered by banks and non-banks (including RSPs) and remittance products based on those transaction accounts, as well as interoperability between payment services and platforms (including for remittance services).

Improving interconnectedness between remittance sending and receiving jurisdictions. TA could assist RSPs' in the strengthening of their implementation of best practices and international standards. This may lead to greater access to payment systems, except in cases where their participation would introduce financial or other risks in the system. Access by RSPs to payment systems should be consistent with Principle 18 of the Committee on Payments and Market Infrastructures (CPMI)-International Organization of Securities Commissions (IOSCO) *Principles for financial market infrastructures*.[7] Similarly, technical standardisation and standardisation initiatives such as ISO 20022 could generally support the interoperability of clearing and settlement infrastructures.

Collecting data to monitor the evolution of the remittances market. TA could be used to support the collection of additional data on the remittances market, including for the World Bank's Remittances Prices Worldwide database.

2. Extent of the problem and possible causes

Extent and impact of the problem

In its November 2015 report to the G20 on actions taken to assess and address the decline in correspondent banking relationships[8], the FSB noted the possible negative impact that the loss of correspondent banking services could have on financial inclusion. The loss of CBRs poses a major challenge to the provision of remittance services to certain regions of the world and in particular for those developing countries where remittance flows are a key source of funds for households. In many jurisdictions remittances represent a significant percentage of GDP (see figure 1).

While some jurisdictions experienced a withdrawal of CBRs following the global financial crisis, cross-border payments have remained stable, and economic activity has been largely unaffected. In a limited number of jurisdictions however, particularly small and fragile states, financial fragilities have been accentuated as cross-border flows became concentrated as a result of fewer CBRs and disruption in access to correspondent banking for some RSPs.

According to the World Bank, inflows from remittances were equivalent to more than 10% of 2015 GDP in 29 countries, and more than 20% in eight of them.[9] Although data is not yet available for 2017, remittance volumes are expected to increase; an increase in volumes is also expected in 2018. It is worth noting however, that the World Bank's definition of remittances

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7 See https://www.bis.org/cpmi/publ/d101a.pdf.

8 See http://www.fsb.org/wp-content/uploads/Correspondent-banking-report-to-G20-Summit.pdf.

9 See http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data.

takes into account a broader range of flows than those transiting through RSPs. Remittances as measured by the World Bank[10] include transfers that flow entirely through the formal banking system, without RSP interaction.[11]

A part of these remittances go entirely through the banking system in the sending and receiving countries, while another part involves, at one or both ends, non-bank institutions such as MVTS, which include RSPs. These operators play a significant role in serving migrant populations, remittance corridors with small communities, or transfers to vulnerable jurisdictions.

Although remittances are in general positively correlated with economic conditions in the sending markets, as mentioned above, global remittance levels did not experience a significant decline following the recent global financial crisis. Moreover, buoyed by the return to growth in the United States, European Union (EU) and Russia, remittance flows to low- and middle-income countries are projected to rebound by 4.8% to USD 450 billion in 2017 and 3.5% to USD 466 billion in 2018. Global remittances, including flows to high-income countries are projected to grow by 3.9% to USD 596 billion in 2017, and by 3.5% to USD 616 billion in 2018, rebounding after two years of decline to the multi-decade growth path that remittances have charted since 2000.[12]

Sub-Saharan Africa, Europe and Central Asia, and Latin America and the Caribbean are likely to be the beneficiaries of the strongest growth in remittance inflows while Gulf Cooperation Council countries[13] remittance flows to East and South Asia are expected to soften due to low oil prices and fiscal tightening policies.[14]

As indicated in figure 2, remittance volumes have trended upwards over the past 25 years, with a more pronounced increase in the past 15 years. While remittance costs have declined over the past decade, the global average cost of sending USD 200 remained stagnant at 7.2% in the third quarter of 2017 and is well above the United Nations' Sustainable Development Goal target of 3%. Sub-Saharan Africa, with an average cost of 9.1%, remains the highest-cost region.

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[10] See http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/overview#2

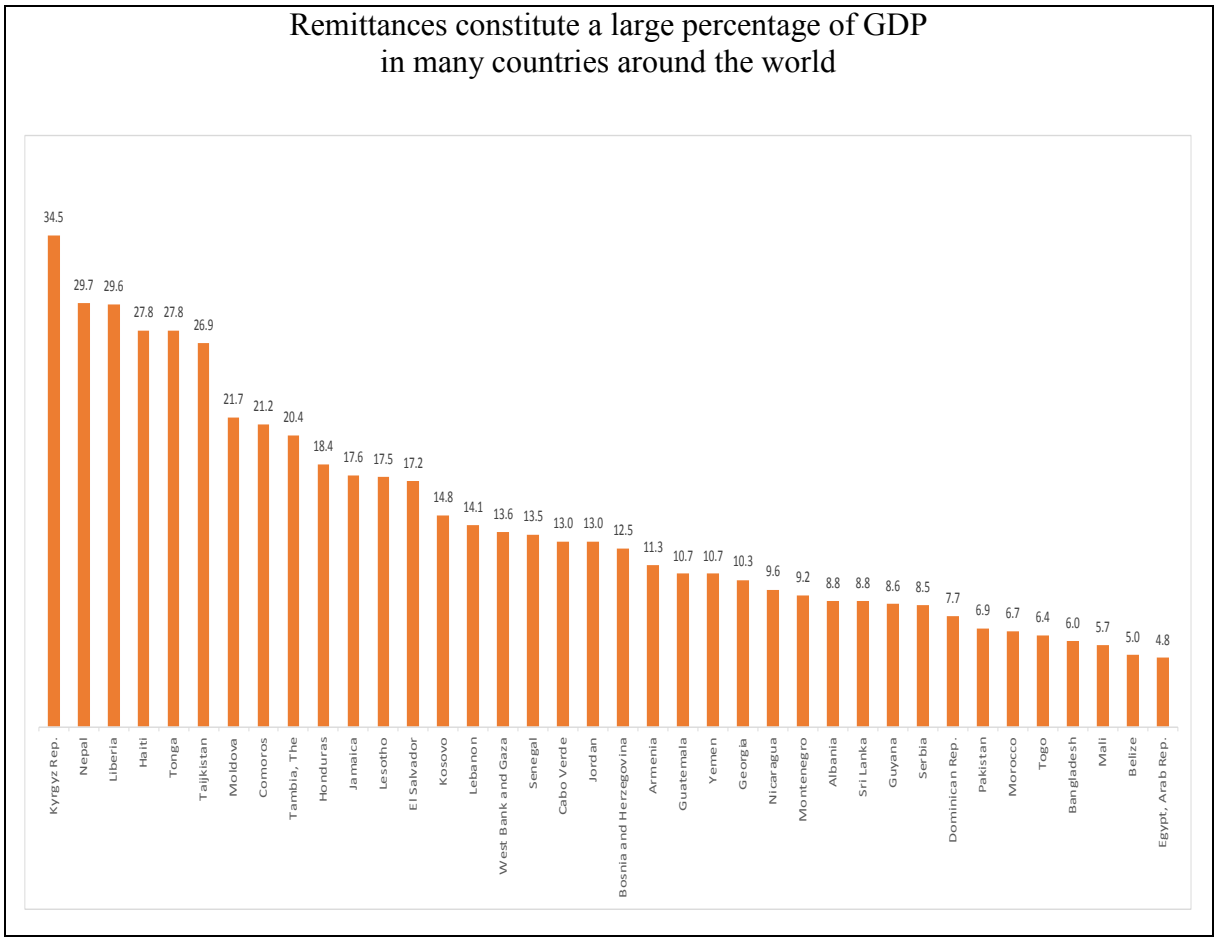
[11] For such transfers (i.e. from bank account to bank account) a different set of FATF Recommendations applies as compared to transfers that involve an originator and/or beneficiary without a bank account.

[12] See the World Bank's Migration and Development Brief 28, October, 2017, available at http://www.knomad.org/sites/default/files/2017-12/Migration%20and%20Development%20Report%2012-14-17%20web.pdf.

[13] Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

[14] See http://www.knomad.org/sites/default/files/2017-12/Migration%20and%20Development%20Report%2012-14-17%20web.pdf.

Figure 1


Remittances constitute a large percentage of GDP
in many countries around the world
34.5
29.7
29.6
27.8
27.8
26.9
21.7
21.2
20.4
18.4
17.6
17.5
17.2
14.8
14.1
13.6
13.5
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10.7
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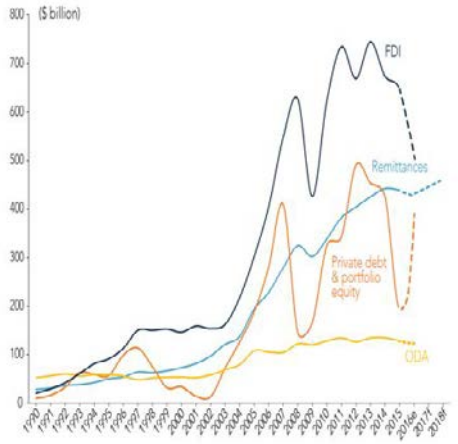
10.3
9.6
9.2
8.8
8.8
8.6
8.5
7.7
6.9
6.7
6.4
6.0
5.7
5.0
4.8
Kyrgyz Rep.
Nepal
Liberia
Haiti
Tonga
Tajikistan
Moldova
Comoros
Tambia, The
Honduras
Jamaica
Lesotho
El Salvador
Kosovo
Lebanon
West Bank and Gaza
Senegal
Cabo Verde
Jordan
Bosnia and Herzegovina
Armenia
Guatemala
Yemen
Georgia
Nicaragua
Montenegro
Albania
Sri Lanka
Guyana
Serbia
Dominican Rep.
Pakistan
Morocco
Togo
Bangladesh
Mali
Belize
Egypt, Arab Rep.

Figure 2

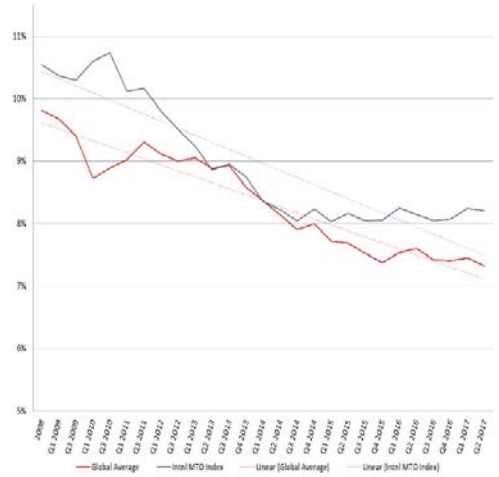
…Remittance flows to developing countries are larger than official development assistance



Sources: World Bank staff estimates, World Development Indicators. See annex A for data and forecast methods. Note: FDI=foreign direct investment; ODA=official development assistance.

… Global average cost of sending remittances continue to drop, although they remain above the United Nations Sustainable Development Goal

(Average cost of sending the equivalent of USD 200 in the first half of 2017)



According to World Bank research, despite a significant reduction over the last decade in the cost of sending remittances, there remain several factors that challenge further reductions. Among these are the de-risking behaviour of commercial banks and the exclusive partnerships between some RSPs and a large number of agents. Exclusive partnerships between large number of agents in either the source or the recipient jurisdiction and any single RSP also hamper market competition, keeping fees high.

In spite of this, an April 2017 IMF Board Paper[15] noted that the increase in the costs of remittances remained modest in most countries. In 2015, when the rise in costs was the strongest, 5% of all countries in the sample experienced an increase in costs higher than 30%, implying an additional fee of more than USD 2 on a USD 100 transfer. In most cases however, the increase in fees did not last and was followed by a period of decline, offsetting the initial adverse impact on remittances.

As was discussed at the FATF Private Sector Consultative Forum in Vienna in April 2017, over the past several years, changes in the structure of correspondent banking relationships have in some cases put pressure on RSPs' ability to access banking services. The decline in CBRs has also led to the termination of services by banks to some RSPs. Access to banking services is at the very core of RSPs' operations with some smaller providers taking the view that a lack of access may affect their viability.

The *FSB Correspondent Banking Data Report,* published in July 2017, included results of a survey of 345 banks in 48 jurisdictions and analysis of an anonymised dataset on correspondent

[15] See https://www.imf.org/~/media/Files/Publications/PP/031617.ashx

banking activity data, as of end-2016, provided by the Society for Worldwide Interbank Financial Telecommunication (SWIFT).[16] The data provided by SWIFT shows that the number of active corridors decreased by 6.3% during the period 2011-2016 and the number of active correspondents by 6% across all currencies. For both the USD and Euro, the number of active correspondents decreased over that same period by approximately 15%.

The World Bank's 2015 survey on the withdrawal from correspondent banking[17] found that RSPs are among the most affected by the decline in correspondent banking services, as reported by over 69% (27 out of 37 responses) of banking authorities surveyed. According to the survey, some jurisdictions in which RSPs are most affected are among the top remittance recipient countries, in terms of value. Another World Bank report on the remittance market[18] shows that 28% of the surveyed RSP principals and 45% of the RSP agents could no longer access banking services. This is an important point since concentration of the remittance sector may have undesired effects on both financial stability and financial inclusion.

In addition to financial stability and financial inclusion considerations, there are concerns that a generalised reduction in access to banking services in some country pairs may drive flows underground, encouraging the operation of unregulated operators and cash couriers, potentially increasing the ML/TF risks. In some instances, RSPs have resorted to alternative channels to clear and settle cross-border transactions that are less transparent and more costly; for example, using other RSPs, operating via cash management companies and physically transporting cash and using personal bank accounts.

Possible causes of the problem

Existing evidence points to a variety of intertwined drivers for the termination of banking services to RSPs, including profitability, the perceived high-risk of certain RSPs' practices, general poor industry supervision and compliance with international standards in some jurisdictions.

The World Bank *Report on the G20 Survey on De-risking Activities in the Remittance Market*[19] identifies the main reasons for the closure of RSPs' accounts by banks as being: profitability; pressure from other actors (e.g. correspondent banks) and fear of regulatory scrutiny; lack of confidence in the RSPs' procedures; the potential increase of reputational risk; and banks' lack of confidence in the supervision of RSPs. The cash-intensive activities of some providers in the remittance sector also contributes to a perceived high level of risk which, taken together with the above-mentioned reasons, point to an economic incentive for banks to close RSPs' accounts.

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16 See http://www.fsb.org/wp-content/uploads/P040717-4.pdf.

17 See http://documents.worldbank.org/curated/en/113021467990964789/Withdraw-from-correspondent-banking-where-why-and-what-to-do-about-it.

18 See http://documents.worldbank.org/curated/en/679881467993185572/pdf/101071-WP-PUBLIC-GPFI-DWG-Remittances-De-risking-Report-2015-Final-2.pdf.

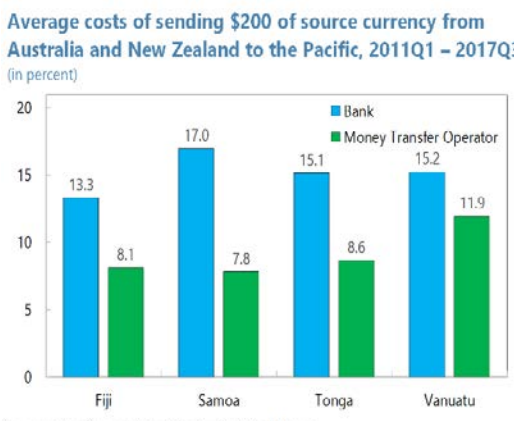
19 Ibid.

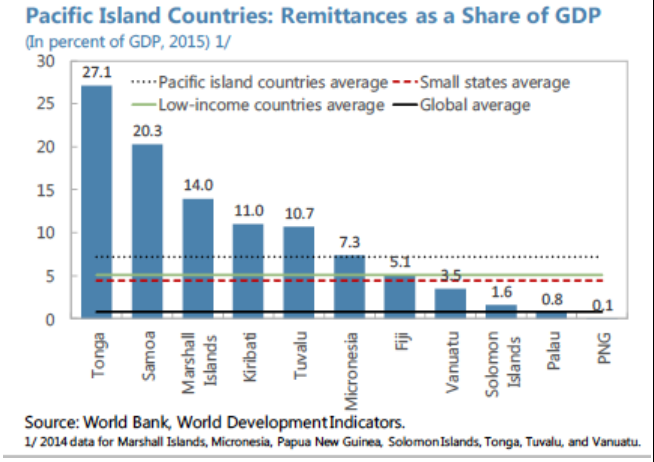
The *FSB Correspondent Banking Data Report* survey noted that 55 small economies were on average served by only four banks from the survey sample[20], suggesting that the absence of a sufficient volume of business and resultant low profitability may deter correspondent banks from offering and/or maintaining relationships with respondent banks given the fixed costs associated with opening and maintaining a relationship. Since RSPs frequently rely on CBRs, this development negatively affects their ability to conduct business. The Caribbean countries are exploring options, including industry consolidation and platforms for aggregating transaction flows, that may help address the profitability driver.

Box 1: Drivers of de-risking in the Pacific

Small island developing states (SIDS) – especially those in the Pacific – face greater exposure to the drivers of de-risking than other larger developing regions that depend on remittances. The relatively small size and scale of SIDS economies, large internal geographical dispersion, and limited financial inclusion pose binding constraints on financial sector profitability and operations. The large distance of many SIDS from major markets increases informational asymmetries and market understanding of risks. Physical constraints are compounded by other challenges, such as small populations and limited capacity, resulting in weaknesses in AML/CFT compliance as well as the business model of the RSPs that operate by bundling a large number of two-way transfers that are then netted out raising "know your customer" (KYC) concerns.

Countries in the Pacific have experienced some of the largest rates of withdrawal of correspondent banking relationships. The consequences of these withdrawals have been felt mainly in the remittances sector. A large number of RSPs have had their bank accounts unilaterally closed by banks. The majority of RSPs that have faced these consequences are corridor specialist operators and in some of these jurisdictions, a global RSP may still operate. These specialist operators tend to offer lower cost services (for example, in Samoa, RSPs handle just over half a million inward money transfers a year, with an average size of just USD 270) – and provide financial services to more remote parts of the Pacific – than





[20] Against an average of 14 banks for all countries for which GDP is available. These economies may be served by banks outside the survey sample.

larger global RSPs. Average remittance costs in the Pacific – which are higher than global averages and significantly above G20 targets – have started to increase. In addition to increases in costs and reduced availability of remittance services, a recent IMF working paper suggests that continued de-risking could increase systemic risks in the financial system of certain SIDS, exclude communities from financial services, and leave Pacific islands even more vulnerable to natural and economic shocks.[21]

The *FSB Correspondent Banking Data Report* found a correlation between the rate of correspondent bank exit and lack of information on the level of compliance with FATF standards and/or weaknesses in the AML/CFT compliance framework. In February 2014 for example, the FATF publicly identified Afghanistan and Cambodia as having made insufficient progress in addressing deficiencies in their AML/CFT frameworks. According to the *FSB Correspondent Banking Data Report*, these two jurisdictions experienced an exit rate of 57% and 23% of their correspondent banking relationships, respectively; these figures are similar to the average exit rate of the 20 jurisdictions that had never been assessed by FATF for compliance with FATF standards as of February 2017 (43%).[22]

This report considers the causes and potential solutions to counter banks' withdrawal of services to RSPs in four broad areas: common characteristics and practices associated with the remittance sector (section 3), international standards and oversight of the remittance sector (section 4), the role of innovation (section 5), and TA (section 6).

3. Common characteristics and practices associated with the remittance sector

The stocktake and meetings conducted as part of the FSB's work on remittances show that banks often perceive the remittance sector in entirety as high risk and that certain characteristics and practices within the RSP sector could be drivers of de-risking by banks. The diversity of firms engaged in providing remittances as well as certain business models may also contribute to a broader perception of higher risk by the banking sector.

RSPs' business model includes several risk factors of concern to banks: RSPs often handle large numbers of cash transactions which are generally viewed as higher risk; many RSPs send money to jurisdictions which are considered high geographic risks (e.g. because of conflict, terrorism, or weak supervision); and RSPs conduct business through agent networks and on behalf of occasional customers with whom they do not have an ongoing relationship. These are inherent risks, which need to be mitigated through internal controls.

RSPs are very diverse in terms of size, sophistication, type of institution, and target market segment, as well as other characteristics. This diversity may lead to challenges for banks when conducting individual risk assessments and avoiding generalised perceptions (e.g. of the

[21] See http://www.imf.org/en/Publications/WP/Issues/2017/04/07/Challenges-in-Correspondent-Banking-in-the-Small-States-of-the-Pacific-44809.

[22] See http://www.fsb.org/wp-content/uploads/P040717-4.pdf.

inherent risk of the entire remittance sector, without taking into account the quality of internal controls put in place by individual firms). It is important that banks take decisions on a customer-by-customer basis, taking into account risks in the remittance sector more generally and then applying a RBA to the individual RSP, instead of following a more general, one-size-fits-all approach. Banks should assess the ML/FT risks associated with a RSP relationship by reviewing risks resulting from the products and services offered to the RSP and the individual characteristics of the RSP (i.e., target markets, distribution channels, products and services offered by the RSP). In addition, banks should consider ways in which these risks can be managed and mitigated. Factors that could reduce ML/TF risks would include the level of effectiveness of the RSP's risk management policies and procedures as well as the specific measures put in place by the bank.

RSPs generally conduct bulk transactions and settle through banks only net amounts resulting from the balance of transfers sent and received, instead of individual transfers. While this may allow for low-cost and time-efficient transfers, this practice reduces transparency for banks and can make it difficult for banks to manage the potential risks associated with RSPs' perceived lack of adequate controls, including sanctions screening and ML/TF risks. The practice of settling net amounts does not however, prevent RSPs from collecting information about individual transfers. Indeed, some larger RSPs have systems that enable them to make transaction-level information available if their correspondent bank request access as part of its assessment of ML/TF risk or the RSP's control system of such risks. However, requiring such data management system of all RSPs would affect the cost function of the transfers and potentially undermines the principle that banks need not know their customers' customer.

At the technical workshop organised by the FSB in Brussels in December 2017, representatives from a large RSP observed that because they process large volumes of small value transactions and have dozens of banking relationships, expecting banks to monitor all transactions would be highly duplicative and costly. Some banks however, are of the view that their regulators would not allow them to rely on RSPs CDD processes. This results in banks needing to access information on the originator and beneficiary of all transactions that they help RSPs process. It is also recognised that the bank may occasionally need to request more information, including on underlying customers, in line with FATF guidance on correspondent banking, for instance when an alert is raised in the bank monitoring systems. In all cases where information needs to be shared, participants in the workshop agreed that standardising the format of the information, for instance by using the ISO 20022 standard, and agreeing on the data fields, would help compliance, as well as reduce costs, provided the cost of standardisation does not exceed the benefits. Another element in the discussion of a possible solution is "better" rather than simply "more" information and in this context, the *Wolfsberg Group Payment Transparency Standards* [23] are designed to enhance transparency regarding parties to transactions in international payments.

The stocktake, through a review of Mutual Evaluation Reports of FATF and its regional bodies, found that some jurisdictions, regardless of capacity and financial sophistication, do not

[23] See https://www.wolfsberg-principles.com/sites/default/files/wb/pdfs/wolfsberg-standards/1.%20Wolfsberg-Payment-Transparency-Standards-October-2017.pdf.

effectively supervise RSPs, even where the appropriate legal frameworks to do so exist. The lack of confidence in the supervision of RSPs in some cases raises the risk perception of the sector. Banks in some jurisdictions may perceive that the remittance service provider sector is lightly monitored and not effectively supervised and are therefore of the view that they are being made to act as a pseudo-regulator for the remittance sector. Further consideration of this driver, and recommendations to address it, are included in section 4 of this report.

Remittance transfer providers are also sometimes perceived by banks as lacking the capacity to conduct customer due diligence (CDD) and to comply with AML/CFT or sanction regulations.

Last but not least, the agent networks used by many RSPs (involving a large number and diversity of agents as the contact point with customers) also creates principal-agent issues that complicate the internal control framework of the RSP and makes the sector more difficult to supervise. Principals must remain responsible for their agents and supervisors should consider dissuasive sanctions when it is not the case.

Conclusions and recommendations

The stocktake found that the banking sector does not always apply a RBA to RSPs on a case-by-case basis, but instead is more likely to characterise the entire sector as high risk and therefore, pricing does not always reflect the true cost and risks associated with a particular RSP and its transactions. This finding was reinforced during discussions at the October 2017 FSB High-level Roundtable on Remittances. This perception that the whole sector is risky makes it difficult for RSPs with robust systems and controls to prove that they are a worthwhile client for banks. The FATF interpretive note to recommendation 10 (Customer Due Diligence) sets out examples of potentially higher-risk situations, including businesses that are cash intensive, non-resident customers, etc.[24] These examples however, are not mandatory elements of the standards and are included for guidance only, and may not be relevant in all circumstances. RSPs are of the view that the perception of their sector being inherently high risk is also reinforced by on-site examinations and concerns over law enforcement, which sometimes advise banks to steer clear of the sector, rather than focusing on transparency, i.e., if a provider can demonstrate that it performs adequate CDD then it should be able to access banking services.

There is also a general lack of communication and dialogue between RSPs and the banking sector, as well as an understanding of each sector's concerns. This makes it difficult to identify and understand any problems in a collaborative manner, and then to arrive at solutions. The FSB, GPFI, FATF, IMF, World Bank and other international organisations have, however, engaged in facilitating a dialogue among stakeholders to foster a mutual understanding of the issues and policies to tackle the withdrawal of CBRs, including the impact on remittance corridors and RSPs. Specifically, the FATF together with the FSB, GPFI and G20, organised a dialogue with the remittance and the banking sector in March 2017, as part of the Private Sector Consultative Forum. the FSB organised a High-level Roundtable on Remittances in October 2017 and it subsequently held two technical meetings, the first focusing on the interaction between remittance service providers and banks, and possible innovative solutions, while the

[24] See http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf, pages 62-62.

second technical meeting addressed oversight and supervision of the remittance sector. The IMF on the other hand, has implemented a regional approach to encouraging dialogue between private stakeholders. Roundtables between correspondent and respondent banks, as well as RSPs, involving in some instances the official sector, have been conducted for the Caribbean, Middle Eastern and North Africa, and Pacific Island regions. Plans for engagement in Africa are underway.

The IAMTN is currently considering options for a pilot project to test whether an MVTS industry standard and auditing proposal can successfully address some elements of de-risking. The objective of the initiative is to raise AML/CFT compliance standards and facilitate the flow of remittances. For IAMTN, the objective of this work would be to ensure MVTS providers are clear on the regulatory requirements on them and that banks are aware of MVTS systems and controls. In the UK, for example, they would develop an industry standard, which is compliant with the 2017 Money Laundering Regulations and with HM Revenue and Customs guidance, and which the banks can support.

Further discussion at the roundtable suggested that more could be done for both sectors to understand each other's practices better. Such discussions may provide banks with a more informed understanding of RSPs' practices, risk management systems and compliance with AML/CFT requirements. A better understanding of practices and improvement of the two sectors' collaboration could be achieved through:

- **Fostering dialogue between the RSP's and the banking sectors through public initiatives to improve interconnectedness between both sectors.** The FSB, GPFI, FATF, IMF and World Bank should continue to facilitate a dialogue among stakeholders to foster a common understanding of issues facing the remittance sector and RSPs' access to banking services.
- **Promote private sector initiatives to foster dialogue between the remittance and banking sectors.** Banks and RSPs could work together to enhance the level of understanding, communication and cooperation between themselves; thereby enabling banks to apply a risk-based approach. The banking sector could, for example, clarify with RSPs their expectations concerning AML/CFT compliance and offer assistance, where appropriate.
- **Support of mechanisms to standardise, where appropriate, financial communication, including clearing and settlement infrastructures, between the banking and remittance sectors.** Cost functions, compliance processes and financial communication (including information sharing) would be improved through technical standardisation and standardisation initiatives such as ISO 20022.
- **Supporting actions by the remittance sector, such as the development of a code of conduct, to improve the risk perception of the sector by banks.** Demonstrating the level of AML/CFT compliance could help to improve perceptions surrounding risk management practices within the sector. An example of this is the code of conduct being developed by the IAMTN. The introduction of a private sector certification or periodic independent audits to demonstrate compliance could be a useful complement to the code as it would strengthen the confidence of correspondent banks in the AML/CFT

procedures of RSPs. It is recommended that work on these best practices continue, with a view to pilot it at least at a domestic level.

4. International standards and oversight of the remittance sector

International standards and guidance

The main international standards relevant to RSPs and their access to banking services are the FATF Recommendations[25] (applicable to both MVTS providers and to banks), which set out a comprehensive and consistent framework of measures which countries should implement in order to combat ML/TF, and the Basel Committee's Core Principles for Effective Banking Supervision[26] (applicable to bank supervisors and banks, but not to RSPs), which set out a framework of supervisory functions and prudential requirements.

Within the FATF Recommendations, there is a wide range of measures which apply to MVTS providers and to banks. Among the most relevant for the FSB's work are Recommendation 1 which deals with assessing risk and implementation of a RBA to ensure that measures to prevent or mitigate ML/TF are commensurate with the risks identified; Recommendation 14 which states that "[c]ountries should take measures to ensure that natural or legal persons that provide money or value transfer services (MVTS) are licensed or registered, and subject to effective systems for monitoring and ensuring compliance with the relevant measures called for in the FATF"; Recommendation 16 which defines the type of information that should accompany wire transfers; Recommendation 26 which addresses the regulation and supervision of financial institutions; and Recommendation 35 which requires that jurisdictions have a range of sanctions available to deal with compliance failures.

FATF has also issued guidance documents[27] that provide a better understanding of the RBA applicable to MVTS and the flexibility offered by the FATF Recommendations in its design and implementation. The guidance highlights that one reason the RBA has not yet been widely embraced is that it might not be well understood, and furthermore, that there are potentially negative consequences if the controls designed for standard risks and higher risks are also applied to situations where the risks are lower. A rules-based compliance approach by regulators and financial institutions could exacerbate financial exclusion risk and misallocate supervisory resources, thereby increasing ML/TF risk.

FATF guidance also addresses how MVTS providers gain access to banking services. While the decision to accept or maintain a business relationship is ultimately a commercial one for the bank, supervisors need to ensure that they understand the drivers of and reasons for those commercial decisions. Supervisors could emphasise the variance in risks among different MVTS providers and encourage banks to take into account risk mitigating factors, such as the

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25 See http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf.

26 See http://www.bis.org/publ/bcbs230.pdf.

27 See http://www.fatf-gafi.org/media/fatf/documents/reports/AML_CFT_Measures_and_Financial_Inclusion_2013.pdf and http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-RBA-money-value-transfer-services.pdf.

AML/CFT procedures and controls put in place by MVTS providers. Supervisors need to make clear their expectation that banks also apply the RBA for MVTS providers.

The interpretative note to the FATF recommendation on wire transfers (Recommendation 16)[28], which would include remittances, sets a de minimis threshold for cross-border wire transfers of amounts no higher than USD/EUR 1,000, below which information on the names of the originator and beneficiary, and their account number or a unique transaction reference number should be provided, but need not be verified for accuracy unless there is a suspicion of ML/TF. In addition, unless there is a suspicion of ML/TF or doubts about the veracity or adequacy of previously obtained customer identification data, financial institutions are not required to conduct CDD for occasional transactions under a threshold of USD/EUR 15,000 for wire transfers outside the circumstances covered by the interpretive note. These requirements reflect the lower risks generally associated with smaller amounts, and the need to avoid excessive due diligence costs that would be borne by customers and conflict with the objectives of affordable transfers described above. At the same time however, they may contribute to increased risk aversion by banks towards RSPs because the latter will frequently engage in small value transactions with occasional customers who are therefore subject to less stringent customer due diligence requirements. Systems enabling better information sharing, such as one developed in Mexico, may address this tension. In Mexico, the central bank operates a database that captures and aggregates for each customer the value of their cross-border transactions. Banks are able to access this information and determine the appropriate level of CDD to apply. Another way of allowing banks to verify both the identities of the money transfer remitters and the money transfer recipients may be through open Application Programming Interface platforms through which financial service institutions are able to request, authorise, and share the KYC data of clients.

Turning to the Basel Committee's work in this space, in June 2017, it issued a revised annex on correspondent banking, as part of their guidelines on the *Sound Management of Risks related to Money Laundering and Financing of Terrorism*.[29] These guidelines describe how banks should include ML/TF risks within their overall risk management. They are consistent with and should complement the FATF recommendations.

While the Basel Committee's guidelines do not contain specific mention of RSPs, it is relevant to them. In particular, the guidelines underscore the need for banks to apply a RBA and, from an understanding of the risks they face, to adequately mitigate and address these. The guideline also contains an annex on correspondent banking, setting out the RBA to providing correspondent banking, and highlighting that there is no "Know Your Customer's Customer" requirement in this context.

In addition to FATF and Basel Committee standards and guidance, the CPMI and World Bank have developed the GPs and Payment Aspects of Financial Inclusion (PAFI)[30]. The former is a set of five principles that cover a number of elements of the market for international remittance

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[28] See http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf, pages 70-75.

[29] See http://www.bis.org/bcbs/publ/d405.pdf.

[30] See http://www.bis.org/cpmi/publ/d144.pdf.

services, including the roles of private and public sector authorities. Implementation of the GPs contributes to the development of transparent and efficient remittance markets for end-users. PAFI is a framework designed by the CPMI and World Bank to identify the critical enablers and catalytic pillars of financial inclusion. Its implementation facilitates an increase in transaction account[31] ownership and usage, and as a result, a more transparent and cost efficient flow of remittances.

Since international standards and guidance are not legally binding at a national level, they are implemented domestically through a jurisdiction's own laws, regulations and guidance. The stocktake found that many jurisdictions have issued the necessary laws and regulations consistent with international standards; few however, have gone beyond this requirement by issuing implementation guidance. Doing so would assist both banks and RSPs to properly implement laws and regulations and in the case of banks, manage the risks associated with RSPs and in following the RBA to the banking of RSPs. Domestic implementation not only provides the necessary authority, but it also provides guidance on how to interpret and apply relevant international standards. The statement by the US Treasury's Financial Crimes Enforcement Network (FinCEN) on providing banking services to money services businesses in November 2014 on the RBA and providing financial services to money services businesses offers a useful example.[32] Similarly, a report from the 11-13 May 2017 G7 Finance Ministers and Central Bank Governors meeting entitled *Promoting Best Practices in the Money or Value Transfer Services Sector*[33] takes stock of the respective G7 frameworks for MVTS with a focus on supervision and risk-based monitoring by competent authorities. Guidance and information of these types can increase clarity and consistency concerning expectations.

Similarly, supervisors in some jurisdictions could better communicate, to banks in particular, their approach and strategy for oversight of the remittance sector. Doing so may give banks greater comfort that the sector is being effectively overseen and encourage them not to characterise all RSPs as high risk and as a result, sever relationships with all providers. To the extent possible, publication of reports by national authorities that assess risk in the remittance sector may also enable stakeholders to make more informed decisions. An example of such a report is the Australian Government's (AUSTRAC) assessment of the overall ML/TF risks associated with remittances sent through remittance providers from Australia to Pacific Island countries.[34]

Oversight of the remittance sector

A review of recent mutual evaluation reports by the FATF and its regional bodies, as well as publicly availably enforcement actions taken at a domestic level, show that many jurisdictions, although certainly not all, have created legal and regulatory frameworks for RSPs that are

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[31] A transaction account is broadly defined as an account held with a bank or other authorised and/or regulated service provider (including a non-bank) which can be used to make and receive payments.

[32] See https://www.fincen.gov/sites/default/files/news_release/20141110.pdf.

[33] See http://www.g7italy.it/sites/default/files/documents/Promoting%20Best%20Practices%20in%20the%20MVTS%20sector%20.pdf.

[34] See http://www.austrac.gov.au/sites/default/files/remittance-corridors-risk-assessment.pdf.

technically compliant with FATF standards. These frameworks vary from jurisdiction to jurisdiction, reflecting the diversity of the sector. That said, there appears to be very uneven implementation of the frameworks that, in turn, leads to supervision of the remittance sector that ranges from active and effective to complete absence.

When reviewing FATF fourth-round mutual evaluation reports, national guidance, and enforcement actions, both positive and negative trends and themes emerged. From a technical compliance standpoint, many jurisdictions appear to have the basic legal framework required by international standards relevant to RSPs. Several jurisdictions also demonstrated strong application of their technical compliance frameworks. Spain and Ireland, for example, have vigorous examination efforts underway, while Italy, Spain and the United States are among those that have taken enforcement actions against non-compliant RSPs. Australia offers an example of a country with robust outreach from the supervisory authority to the private sector and efforts to take action against unlicensed providers.

On the other hand, the review of the mutual evaluation reports of FATF and its regional bodies and available enforcement actions point to a number of weaknesses and implementation problems:

- Many jurisdictions do not appear to have robust supervision for RSPs and quite a few do not effectively supervise them at all. Even in countries with high technical capacity and with generally compliant legal and regulatory frameworks, effective supervision and oversight (e.g., implementation of the framework and data collection), is frequently lacking. Similarly, many jurisdictions appear to have taken few or no enforcement actions against non-compliant providers or agents and some do not examine RSPs providers for compliance.
- One of the most important weaknesses seems to lie in the area of agent supervision, both at the national level and at the provider level. This weakness may also reflect a lack of understanding of their obligations and/or capacity by RSPs, or a lack of resources or recognition of the importance of agent supervision by some national authorities. The problem poses an especially acute deficiency in view of the fact that many of the crucial elements of an AML/CFT programme, such as identity verification, occur at the agent level.
- RSPs and their agents that are headquartered in an EU member jurisdiction sometimes have foreign operations in other EU member jurisdictions via the EU passporting system. These foreign operations are subject to the AML/CFT requirements of, and supervision by the host jurisdiction. In spite of this, some FATF mutual evaluation reports of EU member jurisdictions mention inadequate coordination between home and host supervisors and resultant confusion over responsibility for supervision of foreign-registered providers and their agents operating in the host jurisdictions. In such cases this leaves foreign-registered providers and their agents unsupervised and less regulated than domestic providers and their agents.
- In some jurisdictions, a lack of clear and sufficient requirements for licensing/registration remains a concern, and the persistent existence of unregistered

providers in some countries raises questions about how well these requirements are being implemented.

- There is also a general lack of effective, proportionate, and dissuasive sanctions for providers who do not adhere to the standards. Several mutual evaluations noted insufficient sanctions and relatively few jurisdictions have taken major enforcement actions in significant numbers.
- Finally, evaluations noted insufficient understanding of risks and/or the risk-based approach in some jurisdictions, with weak risk understanding more commonly a problem at the provider level than the supervisor level.

The RBA to oversight depends on in-depth knowledge of the remittance sector, including RSPs' business models, on the part of supervisors in order to identify risks and appropriately allocate resources. Developing this understanding for national authorities requires access to a variety of information sources, including financial intelligence, national risk assessments (including provider and sectoral risk assessments), law enforcement, and international expertise and guidance. RSPs themselves have a crucial role to play in the quality of the AML/CFT monitoring framework. RSPs are responsible for understanding and assessing their risks and implementing appropriate AML/CFT programmes and for overseeing the conduct of their own agents. As a result, providers themselves form an important part of the oversight regime.

The complexity, diversity, and often the sheer size of the remittance sector and the principal-agent model make risk-based supervision very challenging and resource intensive. Enhancing cooperation among supervisors can help to overcome some of these challenges. In particular, some jurisdictions have different supervisors for various prudential concerns as opposed to AML/CFT, especially where there is a separate system of oversight for payment services. Improved coordination between these supervisors could help alleviate the challenges inherent in supervising such a large and complex sector.

Box 2: Promoting remittances through regulated channels – Pakistan's experience

Although Pakistan is a leading labour exporting country, until 2008 the inflow of remittances through regulated channels was rather small. In order to promote remittances through regulated channels, the Ministry of Finance, State Bank of Pakistan (the central bank) and Ministry of Overseas Pakistanis jointly launched the "Pakistan Remittance Initiative" (PRI) in 2009. The PRI included the following measures, intended to regulate the inflow of remittances:

- Increased the number of domestic and overseas remittance locations:
  - Domestic: engaged over 10,000 domestic bank branches, microfinance banks, telecom companies and their franchise networks for the disbursement of remittances
  - Overseas: engaged with money transfer firms around the world – bilateral agency arrangements between domestic financial institutions and overseas entities increased manifolds during this period

- Implemented real-time gross settlement to transfer and settle interbank home remittance transactions that discontinued the issuance of banking instruments to beneficiary if (s)he has an account with another bank. To ensure that the account is credited within 24 hours, a monetary penalty regulation has been introduced, in terms of which banks have to pay 65 paisa per thousand rupees per day compensation to beneficiary.
- Encouraged banks to invest in IT infrastructure that helped introduce instant A/C credit facility through Inter Bank Fund Transfer.
- Encouraged banks to offer remittance services to non-customers. KYC requirements are addressed in part through national identification cards; at the same time, financial inclusion and financial literacy objectives are addressed since many of the unbanked customers opened bank accounts.
- Recommended that banks establish Home Remittance Cells to resolve remittance-related complaints and respond to queries, provide training to bank staff, undertake marketing of remittance services to the public and strengthen correspondent banking relationships.
- Conducted financial training program for intended emigrant workers to educate them how to send remittances through regulated channels and encourages them to have their own and family members' bank accounts before leaving the country. PRI also initiated awareness sessions at different universities in remittance rich areas.
- PRI established a Customer Service & Complaint Management System which includes a call centre for quick resolution of queries and complaints.

According to World Bank data, Pakistan saw a 15% average annual growth rate in remittances over the 2009-2016 period, placing it amongst the top 20 remittance recipient countries.

Conclusions and recommendations

Although international standards relevant to RSPs appear sufficient, a review of the relevant sections of 35 mutual evaluations suggests a lack of understanding about some of their key tenets, for example, the RBA, by some jurisdictions. Despite the 2016 publication by the FATF of guidance to assist jurisdictions and their RSP and banking practitioners in applying the RBA, few of them have done so. Some jurisdictions lack regulations necessary to implement aspects of the international standards, including a clear requirement for RSPs to register or acquire licenses. Often, however, the review of mutual evaluations found that jurisdictions have the necessary legal framework in place, but have simply not effectively implemented it. To remedy this, these jurisdictions must first understand the remittance sector and the standards and requirements pertaining thereto, and then intensify their supervision of it.

The complexity and size of the remittance sector, as well as the pace of technological change and the principal-agent business model, make supervision very challenging. The effective implementation of adequate legal frameworks is the best way to give banks confidence that they can manage the risks of offering service to RSPs. For their part, RSPs should ensure that they maintain effective compliance operations, properly supervise their agents, understand and

apply the RBA, use payment messages correctly, respond to inquiries from banks when necessary, and participate in national authority outreach, including that of financial intelligence units (FIUs).

Recommendations to strengthen supervision and oversight of the remittance sector include:

- **National authorities should implement the FATF standards as they relate to RSPs.** In particular, they should: (a) assess the risks associated with RSPs when conducting national risk assessments for ML/TF; (b) ensure that RSPs are licensed or registered, and their agents are either licensed or registered or RSPs are required to maintain current list of their agents; (c) apply a system of risk-based monitoring and inspection of RSPs; and (d) apply criminal and/or administrative sanctions for significant violations of AML/CFT obligations.
- **National authorities should evaluate and improve, as necessary, coordination and information sharing practices**. Effective coordination and information sharing practices among supervisory, financial intelligence, law enforcement and other authorities, responsible for the oversight of RSPs are a critical element of oversight of the remittance sector.
- **National authorities should publish guidance.** National authorities should publish, as necessary, guidance on the RBA and the banking of RSPs, on their regulatory and supervisory expectations for AML/CFT compliance by RSPs, and should consider additional efforts to engage in direct dialogue with the private sector on these issues. Doing so would assist both banks and RSPs to properly implement laws and regulations and in the case of banks, manage the risks associated with RSPs.
- **National authorities should assess whether their models for the regulation and supervision, as well as inspection of RSPs, are effective and properly include a RBA.** If not, authorities should clearly outline what steps they could take to address deficiencies, recognising that this may have an impact on the number of players in the market. Where appropriate national authorities could consider augmenting oversight of the remittance sector with regular reviews by independent parties including external auditors. Doing so would not however, absolve supervisors from their oversight responsibilities.
- **National authorities could consider programmes that would enable supervisors to collect data necessary to effectively oversee the remittance sector and for both supervisors and RSP principals to monitor and assess the risks associated with agents.** National authorities could consider mechanisms that enable them to collect data from RSPs that is necessary for them to properly supervise both the remittance sector as a whole and remittance providers individually. In addition, supervisors and RSPs could require regular reporting on the admission of agents into the remittance sector and that RSPs closely monitor and assess the risks associated with their agents.

5. The role of innovation

The FSB considered technical solutions that could help to address the drivers of RSPs' reduced access to banking services. The findings not only highlighted a number of promising financial technology approaches that could directly address some drivers of de-risking, but also identified a number of opportunities where innovation can be applied to existing tools, including opportunities in the areas of regulation, supervision, compliance and direct government initiatives. It is important to note that while these innovations may mitigate some drivers of the de-risking, they are unlikely in the foreseeable future to provide entire solutions that completely address all drivers of de-risking. Rather, they are tools that could contribute to a system wide approach to addressing the drivers of reduced access while ensuring, at the same time, the integrity and the stability of the financial system through appropriate features and safeguards such as the compliance with the AML/CFT requirements. Pervasive challenges remain, as identified by providers at the High-Level Roundtable, such as the need for FinTech providers typically to maintain relationships with respondent or correspondent banks, and the considerable TA required to establish the necessary legislative, regulatory, and capacity environment.

In the context of information sharing and due diligence, there are a number of financial and regulatory technologies that are currently being developed (some having greater potential than others) and if successful, could improve the monitoring of remittance transactions and in turn reduce compliance costs and profitability drivers of de-risking. For example, big data, artificial intelligence, and machine learning could improve the detection of suspicious activities, especially when applied to large numbers of remittance transactions. Biometry, geo-localisation and face-recognition and more generally electronic KYC systems and e-identification schemes could also facilitate identification, which is among the most difficult challenges in many of the weakest jurisdictions. While it is unclear which of these technologies will prove most useful, it seems unlikely any will substantially alter the calculus of banks in the near term. At best, the capacity of technology to improve the accuracy and lower the cost of effective monitoring systems or ease the burden on payment systems may help make RSPs more attractive to banks in the longer-term.

Such systems are being or have been introduced in some jurisdictions, including Malaysia, Pakistan, Thailand and India. Systems enabling better information sharing, such as the one developed in 2017 in Mexico that enables the secure sharing among domestic financial institutions of information on customers' cross-border transactions can help institutions to better fulfil their CDD obligations. These systems may however, be constrained by data protection and privacy legislation. The Legal Entity Identifier (LEI), a 20 character alphanumeric unique identifier that identifies parties to a transaction, could potentially serve to identify RSPs and their agents and support international cooperation between authorities in charge of overseeing RSPs. The LEI could in particular help manage information on large international agent networks. Legal entities and individuals acting in a professional capacity are eligible to an LEI, although further work would be needed, for instance to assess whether

LEI issuance would work for all individuals acting as agents.[35] In addition to the LEI, payment message standards (such as ISO20022) exist to facilitate financial communication. The February 2018 CPMI report on *Cross-border retail payments* [36] notes that a lack of standardisation at an international level can add to costs and make payments slower and that "efficient use of ISO20022 across borders requires standardisation of the implementation approach".

The CPMI also reviewed payment innovations relevant for remittances. It found that innovation and competition has focused on the end-user facing part of the cross-border retail payment market leading to improvements in convenience. However, the majority of clearing and settlement for cross-border payments still goes through correspondent banking networks, which struggle to handle the higher volume, lower value retail payments. Nonetheless, several initiatives aiming to improve correspondent banking were identified and the emergence of other clearing and settlement arrangements (namely interlinked payment infrastructures and closed-loop proprietary systems) were also noted. Such a variety of clearing and settlement arrangements, providing they were properly overseen and interoperable, could improve the efficiency of the cross-border retail payment market, including remittances.

Other technological solutions may also offer possibilities to help address RSPs' access to banking services. One such possibility is distributed ledger technology (DLT). It has the potential to reduce remittance market reliance on correspondent banking relationships through the use of a distributed ledger system that removes the need for intermediary institutions such as banks or government entities, to verify or facilitate transactions. It may also reduce cost, by avoiding fees charged by intermediaries, and speed up transactions. [37] For the time being however, users of a distributed ledger system will still need a means to transfer funds in and out of such a system. In addition, some RSPs may not have the technical sophistication to implement DLT-based solutions and questions remain as to whether leaping forward from current systems to these more sophisticated technologies is a viable and a wise use of limited resources. One important issue that remains unresolved by many of these technological solutions is the ability to properly identify customers and comply with AML/CFT standards and, more generally, the regulatory framework. At present, virtual currency exchangers and administrators are not regulated and supervised in most of the world's jurisdictions. As the CPMI report on *Cross-border retail payments* notes, peer-to-peer DLTs are "emerging but still nascent".

Other new digital platforms are also growing, such as Xender, Azimo, and PayPal's Xoom remittance product. These products may benefit from lower perceived risk by removing the risks associated with cash, as transactions are initiated via bank transfer, creating a digital audit trail. Many of these platforms do, however, rely on corresponding banking relationships, and

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[35] See LEI ROC, statement on individuals acting in a business capacity, 30 September 2015 (http://www.leiroc.org/publications/gls/lou_20150930-1.pdf). A condition of registration is that the individual is registered in a business registry. The LEI ROC document recognises in some cases as well tax registries or registries of regulated entities.

[36] See https://www.bis.org/cpmi/publ/d173.pdf.

[37] See Stellar Lumens (www.stellar.org) or Ripple (www.ripple.com) as examples of digital currencies applying DLT that result in low costs for micro-transactions.

their access to banking services may suffer from the high risk perception associated with remote transactions. They also depend upon the remittance sender having a bank account.

A further development is the growth in peer-to-peer services such as TransferWise, CurrencyFair and KlickEx, which reduce the need to send funds across borders by matching individual transactions with reciprocal currency needs. These services circumvent the correspondent banking system altogether. However, a significant constraint to this model is that there is likely to be far more funds flowing into remittance-reliant countries than the other way, making the matching of transactions difficult. As a result, peer-to-peer services have to revert to using traditional cross-border channels, which mitigates their benefit.

In many cases these technological solutions will, however, rely on maintenance of a bank account and a correspondent banking relationship, making them vulnerable to the risks outlined earlier in this paper. Additionally, their potential benefit is limited to remittance senders and receivers that have a bank account and/or internet access.

Some jurisdictions are taking steps to support the development of innovative new financial technology products, including for use in the remittance sector, through the establishment of "regulatory sandbox" regimes, innovation hubs or equivalent regimes with the aim of promoting the development of FinTech while maintaining a healthy and stable financial system. The regulatory sandbox is an enabling environment in which businesses can test products under more flexible regulatory standards, assuming appropriate safeguards are put in place. "Innovation hubs" are institutional arrangements whereby regulated or unregulated entities (i.e. unauthorised firms) engage with the competent authority to discuss FinTech-related issues (share information, views, etc.) as well as seek clarifications on the conformity of business models with the regulatory framework or on regulatory/licensing requirements (i.e. individual guidance to a firm on the interpretation of applicable rules). The FATF has initiated a dialogue on how technology-based innovations have the potential to be utilised to better fight ML/TF, and the impact of innovations such as peer-to-peer transfers, distributed ledger-technology or blockchain-based services, analytical tools, KYC utilities, and digital identity. Furthermore, in November 2017, the FATF adopted a supplement to its 2013 guidance on *AML/CFT Measures and Financial Inclusion*[38] which provides country examples of CDD measures involving technological solutions such as the use of digital identity products and services.[39] It should be noted however, that regulatory sandbox frameworks are generally short-period and small-scale trials, and innovations developed within these regimes still require proper regulation.

Box 3: Regulatory sandboxes

Regulatory sandboxes are regulatory frameworks established by financial sector regulators to allow live testing of financial innovations in a controlled environment. This environment usually involves special exemptions or time-limited exceptions to regulatory supervision requirements, but does not include exemptions from AML/CFT requirements. Sandboxes are

[38] See http://www.fatf-gafi.org/media/fatf/content/images/Updated-2017-FATF-2013-Guidance.pdf.

[39] See http://www.fatf-gafi.org/publications/financialinclusion/documents/financial-inclusion-cdd-2017.html.

designed to encourage active dialogue, collaboration, and engagement between regulators and financial service providers. More than 20 jurisdictions now host such sandboxes. In many of these jurisdictions, sandboxes are complemented by other innovation mechanisms such as hubs or accelerators that provide further room (and in some cases fiscal incentives) for innovation.

Although data on the use of sandboxes is limited, emerging studies[40, 41] point to wide use of such sandboxes and innovation hubs by RSPs and other cross-border payment service providers. Providers are using sandboxes to pilot a variety of financial and regulatory technologies that may have the potential to directly address the drivers of de-risking. These include distributed ledger technologies, fully digital currency exchange platforms, eKYC technologies, and hybrid technological solutions that integrate blockchain technology with existing domestic payments platforms.

However, issues of access to banking may also apply here. In the UK, for example, if a firm cannot secure a bank account it may not meet the Financial Conduct Authority's conditions for authorisation and would therefore be unable to enter the market, even to test in the sandbox. [42] This illustrates how the wider issue of de-risking poses a risk to innovation, particularly when FinTech providers are not regulated for AML/CFT compliance.

There is also potential for jurisdictions to consider innovative ways to more actively support RSPs. The Caribbean Development Bank, for example, has had support from Caribbean jurisdictions to establish a Caribbean-owned entity (bank or clearing institution) in the US, through which regional banks could maintain CBRs. The CPMI notes however, that "while linking multilateral systems may in theory streamline certain processes, this is difficult in practice and may create other operational and financial risks that need to be managed". [43]

There are also opportunities to promote and expand the use of existing technological and regulatory solutions. This could include reducing cash transactions by promoting access to bank and non-bank transaction accounts and remittance products based on those transaction accounts, and reducing dependency on correspondent banking through, where appropriate, greater access of RSPs to payment systems.

Finally there may be opportunities for jurisdictions and regional bodies to provide TA to RSPs to improve their compliance, as discussed in the next section.

Box 4: The European Payment Services Directive 2

[40] See www.cgap.org/sites/default/files/Working-Paper-Regulatory-Sandboxes-Oct-2017.pdf.

[41] See https://www.imf.org/~/media/Files/Publications/SDN/2017/sdn1705.ashx.

[42] See https://www.fca.org.uk/publication/research-and-data/regulatory-sandbox-lessons-learned-report.pdf.

[43] See https://www.bis.org/cpmi/publ/d173.pdf, page 28.

In 2015 the EU adopted a revised Directive on Payment Services (PSD 2)[44] to replace PSD 1 (2007). Under both PSD 1 and 2, RSPs are a type of payment institution and, as such, must be authorised and registered (the RSP principal as well as its branches and agents) and comply with certain prudential requirements, including capital requirements and internal controls arrangements.

PSD 2 aims to open the EU market to new services and providers, enhance competition and data protection, protect consumers when they make payments, promote the development and use of innovative online and mobile payments and make cross-border European payment services safer. The directive, which is complemented by regulatory technical standards developed by the European Banking Authority, was required to be incorporated into national law by January 2018. It includes provisions to improve the efficiency of internet payment services and encourage financial technology innovation, while safeguarding consumer rights and the safety of the financial system.

Payment initiation services are one of the main innovations covered by the PSD 2. Previously unregulated, these services are expected to bring innovation and competition, providing more, and often cheaper, alternatives for internet payments.

For payment institutions such as RSPs, PSD 2 requires that Member States must ensure that credit institutions provide access to payment accounts services in an objective, non-discriminatory and proportionate manner. This aspect is particularly relevant to RSPs as many of them have lost access to the banking system in the recent years. As such, for competition reasons, where a credit institution rejects an application for a payment account, it must be reported to the National Competent Authority with an explanation of the reasons for the rejection.

PSD 2 also extends rules on transparency to payment transactions to persons outside the EU. This should contribute to better information about money remitters, and lower the cost of money remittances as a result of higher transparency in the market.

Finally, PSD 2 requires Member States to designate competent authorities to handle complaints of payment service users and other interested parties, such as consumer associations. Payment service providers that are covered by PSD 2 are also required to put in place a complaints procedure for consumers that they can use before seeking out-of-court redress or before launching court proceedings.

Innovation recommendations

- **National authorities should consider how the regulatory environment could best support greater innovation.** Innovation could be promoted through, for example, the use of sandboxes or innovation hubs, while at the same time managing risk levels and maintaining a healthy and stable financial system.

[44] See https://ec.europa.eu/info/law/payment-services-psd-2-directive-eu-2015-2366_en.

- **National authorities could promote new technologies supporting the identification of customers.** Technologies such as e-ID and those that facilitate the creation of e-ID platforms as well as access to these platforms by financial institutions (including banks and non-banks, and in general all financial institutions providing remittance services) could help to reduce ML/FT risks.
- **Without introducing a technological bias, national authorities should consider digital solutions when drafting and issuing laws and regulations, in order to make them more resilient to future technological developments.**
- **National authorities could investigate and implement – to the extent feasible within national legislation – ways to facilitate end-users' access to transaction accounts offered by banks as well as non-banks.** Access to transaction accounts would increase end-users' freedom of choice and could mitigate their vulnerability to loss of access to cash-based remittance services.
- **Without introducing a bias, national authorities could support the development of FinTech firms through enabling legal and regulatory frameworks.** In addition to creating a supportive environment for FinTech firms and innovation, the frameworks should ensure that FinTech firms are subject to proportionate and risk-based AML/CFT requirements. Authorities could also identify adequate risk mitigation measures for Fintech products, which would contribute to lowering their risk-profile.

6. Remittance-related technical assistance

The stocktake considered both TA activities that (1) directly or indirectly benefit remittance markets and (2) either help mitigate the negative effects of de-risking or make it less likely to occur in the first place. This potentially covers a wider universe than jurisdictions that are currently most affected by de-risking, the rationale being that TA activities designed to improve remittance markets in general are relevant to the objectives of this report.

With the above in mind, TA and capacity-building activities or supporting initiatives are divided into four broad categories: (1) initiatives to promote transparent and cost-efficient remittance markets; (2) initiatives specifically aimed at improving overall AML/CFT compliance; (3) initiatives specifically focusing on jurisdictions most affected by de-risking and (4) initiatives facilitating the provision or coordination of TA or public-private dialogue on the issue, and identifying possible solutions to inform TA programs.

With respect to promoting transparent and cost-efficient remittance markets, the World Bank has provided TA to support the implementation of the GPs and PAFI developed by the CPMI and World Bank (see section 6). Another example of TA in this category is Remittance Prices Worldwide, an online platform to monitor the cost of remittances across 365 corridors. [45] Remittance Prices Worldwide is used to monitor the global target for remittance cost reduction and has been instrumental in putting pressure on service providers to reduce costs. Building on

[45] See http://remittanceprices.worldbank.org/en.

this, TA has been provided to help in the creation of regional or national databases (in France, Italy and other jurisdictions). In addition, the World Bank is delivering TA designed to help with the modernisation of domestic and government payment systems in six focus countries.

The World Bank, IMF and FATF-style regional bodies provide or coordinate TA to improve AML/CFT compliance. The rationale for these activities is that strengthening the general AML/CFT framework, as well as improving AML/CFT supervision directly and indirectly, leads to a more robust compliance environment, including for the remittances sector. This type of TA also prevents AML/CFT requirements from becoming an obstacle to financial inclusion efforts and encourages remittance transactions being executed in the regulated sector.

TA to improve AML/CFT regime development includes strengthening legal frameworks, working with countries to implement risk-based AML/CFT supervision of the financial and non-financial sectors and enhance the operational effectiveness of FIUs. The United States is providing TA on AML/CFT regime development to a number of jurisdictions.

The goal of this TA is strong, stable, accessible, and well-regulated financial sectors that can serve as efficient intermediaries, expand financial inclusion in a safe and sound manner, and that implement preventative AML/CFT measures in-line with the FATF standards. Concerns over inadequate supervision and enforcement have contributed to a perception of increased risk in foreign remittance sectors and introduced impediments to fostering environments that are conducive to cross-border financial transactions, including remittances. There have been however, only few instances of TA specifically dedicated to the strengthening of AML/CFT supervision of the remittance sector (e.g. IMF staff is providing such TA to Uruguay and is currently providing TA to strengthen the supervision of currency exchanges in Jamaica).

More recently, direct TA to address the challenges posed by de-risking has been provided to a number of jurisdictions. Examples include the identification of key drivers and trends affecting correspondent banking pressures and a roadmap to address them, including weakness in the AML/CFT framework in Samoa; support to strengthen the supervision of RSPs in Somalia; work in Tonga and the Pacific Islands on the development of a solution that enables cross-border remittances without having to have a correspondent banking relationship, while at the same time satisfying AML/CFT requirements; and support to improve the electronic payments infrastructure (replacing a manual inter-bank payment system) in several Pacific island nations.

Finally, a number of initiatives are underway to facilitate the delivery and effectiveness of TA. These include the coordination of TA efforts by the World Bank, surveys on de-risking in remittance markets and correspondent banking, national inter-agency remittance task forces (e.g. the New Zealand government inter-agency working group that is working to identify ways of addressing risks to availability of remittance services), and regional initiatives such as the one to be launched in the Pacific – led by the IMF and supported by the governments of Australia and New Zealand – that intends to develop practical, concrete and actionable solutions to help stem the withdrawal of correspondent banking relations.

Box 5: Technical assistance in the UK– Somalia remittances corridor

An example of government involvement is the action taken by the UK Government in 2015 to support the UK–Somalia remittances corridor. As a result of growing concerns from banks

around lack of compliance, many Somali RSPs had their bank accounts closed, leading to potential risks to the flow of remittances from the UK to Somalia. To address this, the UK Government established the UK Action Group on Cross-Border Remittances as a multi-agency effort to support the continuous flow of remittances in this corridor.[46] A specific action from this group was the establishment of the "UK-Somalia Safer Corridor Initiative"[47], bringing together the UK Government, supervisors, the UK banking sector, the UK MSB sector, the World Bank and the UK Somalia community. TA under the initiative commenced in April 2016. The World Bank works alongside the Central Bank of Somalia to implement a number of activities aimed at tackling key deficiencies affecting remittance flows to Somalia, within the broader goal of a more robust financial system. The World Bank activities contribute to developing the regulatory framework and building supervisory capacity in Somalia, and are currently focused on improving the transparency and compliance in Somalia's money service business sector.

Technical assistance recommendations

Based on the analysis of the main causes of de-risking, as well as the need to implement the relevant international standards and significantly improve supervision and oversight of RSPs, and taking into account the goal to more specifically address de-risking situations, the following areas could be the focus of more intensive TA efforts:

- **Strengthening regulation and supervision of RSPs, where necessary.** TA providers should prioritise capacity building, consistent with international standards and guidance, such as the GPs and FATF standards, to the areas of regulation and supervision where material weaknesses have been identified. These include appropriate licensing procedures; effective risk-based supervision; adequate cooperation between supervisors, including between AML/CFT supervisors and payment systems overseers; and proportionate and deterrent administrative, civil or criminal sanctions in case of non-compliance or illegal provision of services.
- **Developing national risk-assessments on determining the risk of different types of RSPs and following-up with initiatives to resolve any gaps.**
- **Reducing the use of cash in remittance flows**. TA could be directed at efforts to promote the access to and use of transaction accounts offered by banks and non-banks (including RSPs) and remittance products based on those transaction accounts, as well as interoperability between payment services and platforms (including for remittance services).
- **Improving interconnectedness between remittance sending and receiving jurisdictions.** TA could assist RSPs' in the strengthening of their implementation of best

[46] See www.gov.uk/government/uploads/system/uploads/attachment_data/file/418690/15-03-11_UK-Somalia_Remittance_Factsheet.pdf.

[47] See www.gov.uk/government/uploads/system/uploads/attachment_data/file/471064/UK-Somalia_Safer_Corridor_Initiative.pdf.

practices and international standards. This may lead to greater access to payment systems, except in cases where their participation would introduce financial or other risks in the system. Access by RSPs to payment systems should be consistent with Principle 18 of the CPMI-IOSCO *Principles for financial market infrastructures*.[48] Similarly, technical standardisation and standardisation initiatives such as ISO 20022 could generally support the interoperability of clearing and settlement infrastructures.

- **Collecting data to monitor the evolution of the remittances market.** TA could be used to support the collection of additional data on the remittances market, including for the World Bank's Remittances Prices Worldwide database.

[48] See https://www.bis.org/cpmi/publ/d101a.pdf.