

Low-risk banking in high-risk countries

De-banking can have the unwanted side effect of excluding millions of people from the global financial system. Inclusion is a necessity in creating a secure banking network



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According to *Cabaret*, money makes the world go round. With only a few exceptions, the lives of everyone on the planet involve processing transactions and the movement of money; it is as important to multinational commerce as it is to a market trader in Malawi.

But our access to finance and efficient financial services is anything but equal. In the West, we take banks, cashpoints, loans and other financial products for granted. In many developing and crisis-hit regions, however, an open and well-functioning financial system is a distant dream.

Technology and financial inclusion

In recent years, technological innovation has helped millions of people who have not previously had access to reliable financial services. Mobile phone payments in particular have reached millions of the 'unbanked' across the globe. In at least eight countries, more people now have mobile money accounts than traditional bank accounts. According to *The Economist*, within six years of the introduction of Kenya's first mobile phone payment system, the value of transactions made by mobile phone in the country reached \$24bn – half the value of its GDP.

This is excellent news for those offering the services, for companies hoping to reach new markets, and for developing countries themselves. The more people who have access to a safe, reliable financial system, the better off we all are.

To misquote *Cabaret*: financial inclusion makes the world go round.

Unintended consequences

In the past few years, though, the momentum has slowed. Since the financial crisis, many regulatory and compliance initiatives have been introduced with the intention of improving trust and confidence in financial markets. Unfortunately, the cost of this additional compliance work has impacted banks' profitability, with the unintended consequence of moving banks and other institutions towards de-risking.

Faced with stringent requirements to combat money laundering and the financing of terrorism, as well as the prospect of personal liability for management should something slip through the net, institutions have stripped products and services from high-risk regions and from entire financial services sectors, such as correspondent banks and money services bureaus (MSBs). According to Accuity's research, while the number of banks worldwide continues to increase, there has been a 39 percent drop in the number of correspondent banking relationships since 2013.

The broad-brush approach to de-risking taken by banks has served its immediate purpose in protecting institutions from the threat of reputational and financial damage. However, in the

long term it is simply not sustainable or helpful to people and countries who really need access to fast and efficient financial services.

A striking illustration that was noted in an article by IPTMA is the case of Ram Karuppiah, a money transfer agent who opened an outlet in Darwin, Australia in 2010. At the time, the region was rife with cheap, unregulated and illegal international money transfer activity. Karuppiah spent years convincing local people to use reasonably priced and regulated alternatives, building up a successful business that helped to achieve the Australian Government's objective of encouraging people away from black market money transfers. He even became ACAM-certified so he could put in place compliance controls.

But over a five-year period, Karuppiah steadily found himself 'de-banked', as a succession of institutions refused his business on the basis that remittance providers were too risky on anti-money laundering and sanctions compliance grounds. Without a relationship with a large bank or the connection with correspondent banks that allowed the transfer of funds abroad, his business eventually folded.

De-risking may have been the logical approach, but there was a very human impact. Whether it is a money transfer agent in Darwin or a large bank in Dubai that cannot transact with the rest of the world, the ultimate effect is that millions of people are being excluded from the financial system. But that is not the end of the story – if they are excluded from mainstream finance, they will look for alternatives on the unregulated

and black market. We are in danger of promoting the very problems we are trying to solve.

Not all institutions are equal

Many people could benefit if banks were more willing to work in higher-risk regions. Yes, some countries are riskier than others, but not all individual institutions are equal. Within high-risk regions there are many excellent, well-managed institutions and potential clients. Established banks are, in effect, avoiding what is a rich potential source of revenue. There is always low-risk business to be done in high-risk countries.

We have seen this first hand at Accuity. We have recently worked in the Republic of Congo with a newly established bank to put in place systems that meet the compliance expectations of correspondent banks in the main trading and clearing hubs – effectively allowing this bank to act as a local correspondent institution and open up the region for business.

Similarly, we have worked with banks in Myanmar, including CB Bank, to help them improve their compliance systems in response to the EU lifting its sanctions against the country in 2013. As other sanctions against Myanmar continue to be lifted, we see it emerging as a great destination in which to do business.

The building blocks for financial inclusion are in place. Firms have already shown they can develop products that are needed and widely used in high-risk countries. The second stage is the method of delivery in countries that lack financial infrastructure – banks and fintechs innovate well in this area by focusing on the technology that is readily available, such as mobile phones.

That leaves the final piece of the jigsaw: demonstrable confidence. Banks need to be confident they are effectively managing the risks of doing profitable business with entities, even if in high-risk regions. Correspondent banks and other service providers within those regions need to be able to demonstrate they have high standards of compliance and risk management processes, systems and culture in place.

Granular risk assessment

This means looking beyond the broad-brush approach of assessing risk at a country or sector level. If we are to improve financial inclusion, banks and other institutions need to take a more granular-level approach to identifying and managing risk, looking beyond the geographical red flags of high-risk regions and sectors.

We have the data and the analytical power to examine individual entities – and automation of compliance and risk assessment processes allows us to make those assessments in a cost-effective way.

Typically a bank's 'know your customer' (KYC) processes will address the following three questions: can I verify who my client is? Can I do business with them? And should I do business with them?

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Number of countries in which more people have mobile bank accounts than traditional ones

\$24bn
The value of Kenya's mobile phone transactions

The first question is the most straightforward and sets the framework for assessing the risk to the business as it focuses on who ultimately owns and controls an entity. Who are its ultimate beneficial owners (UBO) and to whom are they linked? Who are they doing business on behalf of? A risk assessment has to be conducted across this network of linked entities and individuals to get a true picture of the real risk of doing business with that particular client or counterparty.

The second question looks for any known reason the bank cannot do business – because of sanctions, for example, or a control order. In some cases the answer will be clear but in others, such as in the case of a narrative sanction, further analysis will be required. Are you confident, for example, that no sanctioned individuals have a controlling stake in the institution and its subsidiaries?

The third question is far broader, wider reaching and, in some cases, more subjective because it is based on a company's own risk assessment and policies. This question seeks to identify if there are any other known risks that would prevent a company from doing business with another. Within certain high-risk jurisdictions, this question might be harder to answer to gain the level of comfort required to be able to conduct business with that entity.

In less high-risk countries, this process is still challenging, as there is a huge amount of structured and unstructured data available. Dealing with high-risk developing regions poses a different challenge, and in certain sectors this challenge is exacerbated: MSBs, for example, are far harder to know than a bank. Similarly, it means finding and accessing data in regions that might not have a huge wealth of easily accessible information. But it is by no means impossible.

The quality of data is essential: the best compliance and risk assessment processes are only as good as the data they rely upon. At Accuity, our financial counterparty KYC and UBO data offers a single source of truth for global intelligence on financial institutions, supplemented with additional information to create a 'risk picture'.

Manage risk and stay competitive

The challenge for institutions operating in high-risk regions is to make sure risks are properly managed, while the business remains competitive and agile. Doing business in high-risk regions is potentially more expensive, but the right tools keep costs at a manageable level, and confidence high.

Ensuring good business is conducted through trusted financial services is paramount to a well-functioning global financial marketplace. The consequence of blanket de-risking – pushing activity outside legitimate financial services, creating even greater systematic risk, and reducing the flow of foreign investment and business in certain regions – is against everyone's interest, and is something intelligent risk management can help us avoid. ■

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