



**STRIKING A BALANCE BETWEEN FINANCIAL INCLUSION AND ANTI-MONEY  
LAUNDERING/ COUNTERING THE FINANCING OF TERRORISM (AML/CFT)  
REQUIREMENTS**

**INTRODUCTION**

Research has shown that financial inclusion is a key enabler to reducing poverty and boosting prosperity in any nation (World Bank Group). The World Bank Group considers financial inclusion a key enabler to reduce extreme poverty and boost shared prosperity, and has put forward an ambitious global goal to reach Universal Financial Access (UFA) by 2020.

According to the World Bank, financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs i.e. transactions, payments, savings, credit and insurance delivered in a responsible and sustainable way. The World Bank further states that being able to have access to a transaction account is a first step towards broader financial inclusion since a transaction account allows people to store money, and send and receive payments. A transaction account serves as a gateway to other financial services, which is why ensuring that people worldwide can have access to a transaction account is the focus of the World Bank Group.

The Financial Intelligence Centre's Financial Inclusion Risk Assessment Report (2016) defined financial inclusion as the process of ensuring access to financial services in a timely manner and at an affordable cost by low income and underserved groups. In other words, financial inclusion is the process of enabling those sectors and segments of the population that are outside the formal

financial system, to become a part of the system. Financial inclusion should be accompanied with financial literacy and financial discipline to make it more sustainable.

The United Nations Capital Development Fund, in its report entitled “*Building Inclusive Financial Sectors for Development*” (United Nations, 2006), defines the goals of financial inclusion as follows;

- i. Access at a reasonable cost for all households to a full range of financial services, including savings or deposit services, payment and transfer services, credit and insurance;
- ii. Sound and safe institutions governed by clear regulation and industry performance standards;
- iii. Financial and institutional sustainability, to ensure continuity and certainty of investment; and
- iv. Competition to ensure choice and affordability for clients.

The main goal and objective of financial inclusion is to achieve universal access to and usage of a broad range of quality and affordable financial services that meet the needs of individuals and enterprises. This will in turn accelerate economic growth and thereby achieve sustainable development.

## **WHY FINANCIAL INCLUSION?**

In 2017, Zambia through the Ministry of Finance developed a National Financial Inclusion Strategy (NFIS) for 2017–2022 meant to provide a roadmap to further accelerate Zambia's financial inclusion journey by setting forth a series of specific, delineated, and sequenced actions for a wide range of stakeholders. Empirical evidence and research in various countries has shown that enhanced financial inclusion contributes to wealth creation, economic growth, and sustainable development.

The NFIS for the country took into account the outcomes of the National Risk Assessment of Financial Inclusion Products which was conducted in 2016. It was believed that, the national strategy will contribute towards further enhancement of financial sector legislation fostering a much clearer enabling environment for financial institutions and other ancillary sector players to continue formulating financial inclusion products and services.

It is imperative that we recognize that there are financial and social consequences arising from financial exclusion. People that are financially excluded might;

- i. Not be able to access affordable credit;
- ii. Not want to obtain a bank account, or have difficulty obtaining a bank account;
- iii. Be financially at risk through not having home insurance;
- iv. Struggle to budget and manage money or plan for unexpected events;
- v. Not know how to make the most of their money;
- vi. Extensively use informal and unregulated financial services, thus making it more difficult to identify money laundering.

### **IMPACT OF AML/CFT REQUIREMENTS ON FINANCIAL INCLUSION**

The Financial Action Task Force (FATF) which is an independent inter-governmental body that develops and promotes policies to protect the global financial system against money laundering and terrorist financing has promulgated international standards which countries need to implement in order to protect their financial systems. These international standards on AML/CFT promote financial integrity and support the fight against crime. At the same time, the FATF has recognized the importance of financial inclusion and is therefore committed to financial inclusion. This is because the FATF believes

applying measures that enable more individuals and businesses, especially low-income, unserved and underserved groups (financially excluded people), to access and use regulated financial services, increases the reach and the effectiveness of AML/CFT regimes. If unserved and underserved people are not financially included and active, they may be forced to conduct their transactions through unregulated channels when they lack access to formal financial services. Further, enabling these groups of people to use regulated and supervised channels supports improved consumer protection against fraud, financial abuse and exploitation. In addition, financial inclusion enables countries to expand the scope of traceable transactions, facilitating the detection, reporting and investigation of suspicious transactions, thereby reducing overall money laundering (ML) and terrorist financing (TF) risks. Financial inclusion and financial integrity are thus mutually reinforcing. Therefore, although there is a perceived conflict between financial inclusion and AML/CFT requirements, the two are actually complimentary.

FATF standards require financial institutions to apply appropriate customer due diligence (CDD) measures commensurate with the risks associated with their clients. This is so because FATF is aware that applying an overly cautious, non-risk-based approach to AML/CFT safeguards when providing financial services (both at the on-boarding stage or in the context of ongoing relationships) can have the unintended consequence of excluding legitimate consumers and businesses from the regulated financial systems. To address this concern, in February 2013, FATF adopted Guidance on AML/CFT Measures and Financial Inclusion, updating the guidance it first provided in 2011 to provide support for designing AML/CFT measures that meet the goal of financial inclusion, without compromising their effectiveness in combating crime. The 2013 FATF Guidance on Financial Inclusion also reflected the changes made to the FATF Recommendations in 2012, in particular the reinforcement of the risk-based approach (RBA). The development and application of risk-sensitive and

proportionate AML/CFT frameworks are a key step for countries that seek to build a more inclusive regulated financial system, and enable a larger proportion of the population to access appropriate financial services especially the most vulnerable and unserved groups.

One of the main financial integrity challenges in a financial inclusion context is the lack of reliable identity documentation and data verification for potential customers. This limitation creates an obstacle to conducting the required level of due diligence. In 2014, the World Bank reported that 18% of all adults without an account cited documentation requirements to establish proof of identity as an important barrier to account ownership. According to the 2018 National Survey on access and usage of information and communication technologies by households and individuals, the level of awareness on the existence of digital financial services currently on offer in Zambia among all individuals aged 10 years and older was estimated at 67.2 percent. The survey estimated that about 29.5 percent of individuals in the country have transacted before, using digital financial services. The main reason cited by individuals that had not used digital financial services was that they had no resources to use the services or they were not registered, accounting for 54.4 percent and 39.1 percent of all the individuals that had not used digital financial services before. The most prominent challenges experienced while using digital financial services were system failure and insufficient float by agents accounting for 55.7 percent and 39.2 percent of individuals that had used digital financial services and experienced some challenges. These requirements could primarily affect people living in rural areas or employed in the informal sector (e.g. individuals paid in cash, undocumented migrants), who are less likely to have formal proof of identity or of address, and other checks often completed by banks in the process of verifying an individual's identity.

Countries have come up with initiatives that can be applied as solutions to provide access to regulated financial services by unserved and underserved people, while complying with CDD requirements. These initiatives show that financial integrity challenges that impact financial inclusion need to be understood in a broad context that includes;

- (1) Understanding of ML/TF risks in the country;
- (2) Developing a financial inclusion strategy, including financial education, to expand the access of the population, especially low-income, unserved and underserved people, to regulated financial services;
- (3) Providing reliable proof of identity mechanisms to the population, including support for developing digital identity systems; and
- (4) Support for developing digital financial services, including through the relevant technical infrastructure, to promote the use of mobile devices and other technology-based channels and innovative ways to provide access to financial services.

## **STRIKING THE BALANCE**

In order to achieve the intended purpose of both financial inclusion and AML/CFT regulatory requirements, there is need to have a holistic and risk-sensitive approach rather than a conservative “One-Size Fits All” approach to AML/CFT implementation. Traditionally, conservative “one-size-fits-all” approaches have been the default position of many countries and institutions when implementing AML/CFT measures. A FATF review of mutual evaluations from 2005 to 2011 found that very few countries had adopted a Risk Based Approach (RBA); instead most countries had mandated the same obligations for all financial institutions regardless of their products or customers. Conservative institutions will tend not to adopt simplified CDD if the decision is left to be made

by them as they will tend to over-estimate risk. In the same vein, conservative regulators may be reluctant to require institutions to relax their approach in AML/CFT requirements.

It is therefore imperative that regulators take the leading role in implementing a risk based approach (risk-sensitive approach) in implementing AML/CFT requirements. FATF's June 2013 guidance paper equips regulators to take a leading role in implementing a RBA and to respond when institutions are being overly conservative. This leading role for regulators is in the spirit of proportional regulation and is important to the advancement of financial inclusion.

In view of the 2013 FATF guidance and technical assistance from the World Bank, in 2016 Zambia conducted a financial inclusion risk assessment which covered the financial institutions and money value transfer services that were offering respective financial inclusion products or services. These are banks, microfinance institutions, insurance companies, mobile service providers, postal services, retail shops, securities exchanges, brokers and fund managers of capital markets. The main aim of the financial inclusion risk assessment which covered the financial sector was undertaken by the country with a view to understand money laundering (ML) and terrorist financing (TF) risks that may arise from both existing and any emerging products and services being offered in Zambia and exploring the room for simplifications in AML/CFT measures in low risk situations. The risk assessment of financial inclusion products was also aimed at ensuring that the outcomes of the assessment assists financial regulators and various market players in undertaking the following:

- (a) Designing or redesigning products or services as the case may be;
- (b) Putting in place necessary mitigating measures and
- (c) Reviewing of existing policies and practices including legislation.

The results of the National Risk Assessment of financial inclusion products indicated that there was no significant use of the products in the generation of proceeds of crime or any significant use to perpetrate terrorist activities in the country. Further, the ML/TF risks for most of the products were considered as low due to monitoring mechanisms put in place by the service-providers, by way of automated AML systems, product operational procedures and transaction limits. From the assessment undertaken, financial inclusion products fall in one of the following categories:

- i. deposit products- normal savings and fixed deposit accounts;
- ii. local money remittances;
- iii. mobile money accounts and remittances;
- iv. group-based savings and credit accounts
- v. micro insurance products;
- vi. unit trusts;
- vii. E-Wallets.

Zambia's achievement in effectively undertaking these parameters as informed by the outcomes of the risk assessment of financial inclusion will ensure that financial inclusion products contribute to the safety and integrity of the financial systems. Further, based on the national risk assessment of financial inclusion products, financial institutions should design their AML/CFT measures that meet the national goal of financial inclusion, without compromising the measures that exist for the purpose of money laundering and other financial crimes. The national risk assessment is a basis for which a country should adopt the risk based approach to implementing AML/CFT requirements.

## **WHAT COULD BE DONE?**

Zambia has made significant strides to accelerate the level of financial inclusion; however, there is more that can be done. Among other things, there is still a



need to increase the use of digital financial services and pursue digital financial inclusion extensively. Digital financial inclusion refers broadly to the use of digital financial products and services to advance financial inclusion. It involves the deployment of digital means to reach financially excluded and underserved populations with a range of regulated financial services tailored to their needs, delivered responsibly at a cost affordable to customers and sustainable for providers. "Digital financial services" covers financial products and services, including payments, transfers, savings, credit, insurance, securities, financial planning and account statements. They are delivered via digital/electronic technology such as e-money (initiated either online or on a mobile phone), payment cards and regular bank accounts. In the recent past, one of the prominent technological developments has been the launching of Virtual Assets (VAs) which are in a form of decentralized digital currency or virtual currency. Examples, of Virtual Assets are cryptocurrencies such as bitcoins which has been described by the World Bank as a subset of digital currencies and defines it as digital representations of value that are denominated in their own unit of account, distinct from e-money, which is simply a digital payment mechanism, representing and denominated in fiat money. The use and promotion of cryptocurrency if managed properly can complement the efforts that are being made towards financial inclusion. The use and application of digital solutions requires that the necessary infrastructure is in place to enable customers in remote areas to be able to access money.

Increasingly, digital financial inclusion also includes the use of digital identity products and services to provide individuals with proof of identity for CDD purposes (though conventional and other alternative means of identifying customers and verifying identity may also be used). It also increasingly involves technological solutions used by financial institutions to fulfil their compliance obligations, for instance through the use of big data collected through mobile phone usage, to monitor customers' transactions in a cost-effective manner. This

is an important factor regarding the sustainability of the business models developed by financial institutions to reach out to low-income, unserved and underserved groups.

Digital financial products and services have developed significantly over the last several years, and have major potential to facilitate access to basic services for unserved and underserved people and businesses, especially in emerging and developing countries. For instance, the emergent and widespread of the M-PESA in East Africa has been one of the good success stories of digital financial service. Safaricom launched M-PESA in Kenya in March 2007 and become the most famous and probably the most successful implementation of mobile money service to date. Fourteen (14) months after the launch, M-PESA in Kenya had 2.7 million users and almost 3,000 agents. Two (2) years after its launch, M-PESA gained 7 million registered customers and 10,000 agents spread across the country. This exceeded the reach of any other financial service in Kenya. Finaccess (2009) showed that M-PESA became the most popular method of money transfer in Kenya with 40% of all adults using the service. The development of branchless banking channels through non-bank agents (e.g. mobile money booths, grocery stores, petrol stations, lottery kiosks, etc.), combined with mobile phone solutions, and e-money accounts have helped reach the unserved or underserved groups and offer them basic, but regulated financial services. A number of regulators around the world have sought to create enabling environments for digital financial services, including with regard to AML/CFT requirements.

The general principle applies that AML/CFT regimes should be defined according to the nature and level of ML/TF risks and the products/channels used, and be adapted if and when relevant. In a number of countries, the expansion of digital financial services has been supported by the implementation of a tiered approach to CDD. Specific legal/regulatory

frameworks to promote mobile money or branchless banking schemes involving the use of digital tools and technical support such as point-of-sale terminals for the use of payment cards have been designed. The scope of the applicable measures is limited and Simplified Due Diligence (SDD) applies only when the products or service are accessed in specific circumstances, for example face-to-face via a non-bank agent or through a mobile phone or an e-money issuer.

The FIRST Initiative by the World Bank on implementing FATF standards in developing countries and financial inclusion was to fund a five country study to analyze the effects of AML/CFT regulation on access to finance in Indonesia, Kenya, Mexico, Pakistan, and South Africa. The study concludes that AML/CFT measures can negatively affect access to, and use of, financial services if the measures are not carefully designed. The study identifies factors that may intensify this impact, provides approaches on the design of appropriate AML/CFT controls that complement financial access policies, and suggests key design principles for AML/CFT controls. Below are some of the suggestions;

1. AML/CFT measures should be tailored to the domestic environment and the domestic risks of money laundering and financing of terrorism (ML/FT).
2. AML/CFT controls should be proportionate to the prevailing or likely risks.
3. AML/CFT obligations should be matched to the capacity of both public and private institutions.
4. Where institutional capacity is lacking, a plan should be developed to improve capacity and phase in AML/CFT obligations as institutional capacity increases.
5. Law enforcement should be reserved as primarily the responsibility of the state, and law enforcement responsibilities should not be unnecessarily shifted to private institutions.

(Bester et al. 2008)

The above principles can play a key role in designing AML/CFT controls that do not inhibit financial inclusion.

## **CONCLUSION**

As Bester et al. 2008 concludes, it is a well-known fact, the pursuit of financial inclusion and the combating of ML/TF can be, and should be, complementary national policy objectives. When low-income clients are excluded from formal financial services, the goals of the AML/CFT policy cannot be achieved. It is challenging to advance both objectives, but customizing AML/CFT policies to the local context, and implementing them sensitively, can deliver significant benefits to clients and financial services providers.

From the above discussion it can be deduced that the goals of financial inclusion, and AML/CFT requirements, are not inherently in conflict; however, tensions do emerge in practice. Overly restrictive AML/CFT measures may negatively affect access to financial services and lead to adverse humanitarian and other unintended implications. As measures to curb financial crimes are implemented, a tailored and AML/CFT-smart approach to risk that can screen out the riskiest clients and transactions while at the same time including an ever greater percentage of the population within the formal economy should be implemented. This is because, a restrictive, one-size-fits-all approach to risk will result in the exclusion of vulnerable segments of the population from the financial system for the benefit of black market services; likewise, a lax approach to risk is likely to allow proceeds of crime to flow into the legal economy. Therefore we need to strike a balance!