EASTERN AND SOUTHERN AFRICA ANTI-MONEY LAUNDERING GROUP

Survey Report on De-risking in the ESAAMLG Region

September 2017

REPORT OF THE SURVEY TO ASSESS THE EXISTENCE, CAUSES AND IMPACT OF DE-RISKING WITHIN THE EASTERN AND SOUTHERN AFRICA ANTI-MONEY LAUNDERING GROUP (ESAAMLG) REGION

September 2017

WORKING GROUP ON RISK, COMPLIANCE AND FINANCIAL INCLUSION (WG-RCFI)

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ACRONYMS

AML/CFT	Ant-Money Laundering and Combating Financing of Terrorism
ASBA	Association of Supervisors of Banks of America
CAP	Customer Acceptance Policy
CBR	Correspondent Banking Relationship
CDD	Customer Due Diligence
DPA	Deferred Prosecution Agreement
EDD	Enhanced Due Diligence
ESAAMLG	Eastern and Southern Africa Anti- Money Laundering Group
FATF	Financial Action Task Force
FATF-PLEN	Financial Action Task Force Plenary
FIU	Financial Intelligent Unit
G-20	Group of Twenty
IMF	International Monetary Fund
KYC	Know Your Customer
KYCC	Know Your Customer's Customer
ML/TF	Money Laundering and Terrorist Financing
MVTS	Money or Value Transfer Service(s)
NPOs	Non-Profit Organisations
PEPs	Politically Exposed Persons
RBA	Risk Based Approach
UAB	Union of Arab Banks
UK	United Kingdom
UNSCRs	United Nations Security Council Resolutions
USA	United States of America
WB	World Bank
WG-RCFI	Working Group on Risk, Compliance and Financial Inclusion

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EXECUTIVE SUMMARY

Background

I. The increased focus on Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) regulatory compliance in recent years has not only increased the compliance costs incurred by financial institutions globally, but has also increased pressure for compliance to avoid penalties. With this increased pressure to meet compliance standards, financial institutions often take actions aimed at reducing the risk of non-compliance. In some cases, financial institutions can take decisions to further limit their exposure to risk by terminating perceived high risk relationships, customer segments or transactions. This phenomenon has often been referred to as *"de-risking"*.

II. De-risking decisions may inadvertently create new risks to the financial system. For example, decisions such as denial of correspondent banking relationships (CBRs) by correspondent banks may cause respondent banks to also take action to terminate relationships with certain segments of their customers in order to comply with the AML/CFT requirements. This leads to certain customer segments being excluded from the financial system. As a result, the excluded customer segments may conduct transactions that no longer fall within the scrutiny of financial institutions as they will be channelled through the informal sector. This can promote illicit financial flows within a country's economy and stifle financial inclusion initiatives.

III. In view of these challenges, ESAAMLG Council of Ministers approved a survey on de-risking within the ESAAMLG region during its meeting held in Victoria Falls, Zimbabwe, in September 2016. The purpose of the survey was to assess the existence, nature, extent, drivers, impact and responses to de-risking in the region. The survey also sought to establish whether or not de-risking has impacted remittance flows into the ESAAMLG region and financial inclusion efforts. In the survey, de-risking was evaluated from two perspectives i.e. impact of de-risking on CBRs and impact of de-risking on customers of financial institutions.

IV. A Project Team comprising of Angola, Kenya, Seychelles, South Africa, Zambia and Zimbabwe was formed to conduct the survey. A questionnaire was developed and circulated to all 18 ESAAMLG member countries in November 2016 targeting players in the private and public sectors in the ESAAMLG region. This included players in the banking, insurance, securities, co-operative societies, money or value transfer services (MVTS) and forex bureau sectors. Financial sector regulators were also included in the scope of the survey. A total of 633 questionnaire responses were received comprising 601 from financial institutions and 32 from financial sector regulators. All responses were considered for data analysis.

Findings

V. Overall, the survey established that de-risking has affected majority of the member countries within the ESAAMLG region, though at varying levels. Whilst some countries had relatively low levels of impact, others were severely affected particularly countries perceived to be high risk. Economic impacts of de-risking have also been felt across the region. These include difficulties in accessing international payment systems and foreign markets for trade, closure of operations by institutions, reduced scale of operations, diminished financial performance and job losses.

VI. Specific findings from the survey were:

- Impact of de-risking on CBRs: 40% of respondent banks have been impacted by de-risking through termination and/or restriction of CBRs. For some institutions, the terminations and/or restrictions affected multiple correspondent banking accounts in USD, EUR, AUD and GBP currencies. Respondent banks indicated that correspondent banks were more sensitive to certain groups of customers namely MVTS, customers from certain countries, gambling entities including casinos, online casinos, betting companies and lotteries, forex bureaus and non-profit organizations (NPOs). These customer groups experienced terminations by their banks on account of conditions imposed by correspondent banks in at least 25% of the ESAAMLG member countries.

Respondent banks in the ESAAMLG region indicated that the principal reason provided by correspondent banks for the terminations and/or restrictions was a decrease in the overall risk appetite by correspondent banks. The other key drivers of these terminations and/or restrictions were the lack of profitability of certain foreign CBR services/products; changes to legal, regulatory or supervisory requirements in the correspondent banks' jurisdictions that have implications for maintaining CBRs; and concerns about money laundering/terrorism financing risks in the respondent's jurisdiction.

There is evidence that shows that wholesale de-risking of CBRs have occurred in some countries in the ESAAMLG region. As a result, indirect or nested correspondent banking arrangements as an alternative to direct correspondent bank relationships have emerged. A large number of respondent banks now depend on less than two correspondent banks for processing of more than 75% of their transactions.

- <u>Impact of de-risking on customer relationships:</u> 80% of financial institutions in the ESAAMLG region terminated relationships with their customers. The main reason driving terminations by financial institutions was the need to conform to regulatory obligations so as to avoid sanctions and reputational damage. The majority of terminations occurred in the banking sector with lower levels of terminations being reported in the non-banking financial sectors that participated in the survey. Some customer groups were identified as being more vulnerable to termination of relationships. These included customers from/ doing business in high risk countries, customers with negative publicities, PEPs, forex bureaus and

MVTS. There is, however, no evidence to suggest that systematic wholesale de-risking of a particular customer group has occurred in the ESAAMLG region.

- Impact of de-risking on remittances: The survey showed that 4% of the financial institutions reported having terminated relationships with MVTS, with 82% of the financial institutions being in the banking sector. However, less than 10% of MVTS in the region have been affected by de-risking. The effect of de-risking on remittance flows into the ESAAMLG region was also found to be low resulting in less than 10% reduction in remittance flows.

- Impact of de-risking on financial inclusion: For some jurisdictions in the ESAAMLG region, de-risking has negatively impacted access to financial products and services thereby affecting financial inclusion. For these jurisdictions, the product that were most affected (though to varying extents) was access to remittance products.

VII. The survey established that Regulatory Authorities are taking different measures to safeguard the financial sectors from new risks created by de-risking by putting in place incentives to prevent the development of underground financial systems and concentration of risks in smaller institutions with less established AML/CFT programs.

Recommendations

VIII. In view of the existence and effects of de-risking the following recommendations are proposed:

- Countries that have not conducted national risk assessment should do so to enhance their understanding of specific ML/TF risks facing their countries and adopt mitigation strategies commensurate with the identified ML/TF risks;
- Regulatory authorities should strengthen the application of a risk based approach through effective capacity building for their staff and institutions and building a strong legal and supervisory framework;

- Regulatory authorities should require institutions to conduct institutional risk assessments and apply a risk based approach to AML/CFT. Supervision in itself should be focused on assessing the existence, application, transparency and consistency of the risk identification and mitigation strategies applied by financial institutions;
- Countries should evaluate the possibility of working with regional clearing houses that offer payment and settlement systems. The clearing house would take responsibility for ensuring that all participating members have robust AML/CFT frameworks before being on-boarded. It will also ensure that due diligence has been conducted on participating institutions which will give a level of assurance to international correspondent banks;
- Regulatory authorities should further strengthen the licensing and supervisory regimes applicable to financial institutions. Further, sanction regimes should be continuously improved to ensure they are deterrent;
- Regulatory authorities should require institutions that currently rely on manual processes to deploy technological solutions for AML/CFT surveillance, monitoring, customer due diligence and screening;
- Regulatory authorities from the ESAAMLG region should collectively engage with the Regulators of correspondent banks and international policy makers with a view to developing sustainable/ amicable solutions to de-risking challenges;
- Regulatory authorities should endeavour to build trust with correspondent banks and their Regulators by showcasing what the country is doing to ensure a robust regulatory framework is in place;
- Countries should continuously assess their situation with a view to correcting any deficiencies in law and regulations;

- Regulatory authorities should issue guidelines to institutions on the minimum compliance standards for CBRs. In issuing such guidelines, the regulatory authorities should bear in mind the key concerns frequently raised on AML/CFT risks by correspondent banks;
- Respondent banks should establish relationships with more than one correspondent bank for their primary currencies to mitigate against the effect of termination on their business operations;
- Countries should consider diversifying the currencies used in correspondent bank relationships;
- Countries should invest in and deploy appropriate technology to create a centralized database to enhance customer due diligence measures related to customer identification and beneficial ownership of legal persons and arrangements; and
- Countries should maintain statistics and provide updates to the Working Group on steps that have been taken to address de-risking and implementation of the recommendations of the report.

<u>Conclusion</u>

IX. De-risking has adversely affected majority of countries in the ESAAMLG region, it resulted in closure of operations, reduced scale of operations or diminished financial performance. Only a small portion of the de-risked population has been incorporated back into the formal financial sector. Most people that have been de-risked are now in the informal sector. In view of the noted high negative impact of de-risking in the region, there is an increased potential of illicit financial flows and ML/TF risk through ripple effects of informal activities. Therefore there is a need to strike a balance between AML/CFT measures and financial inclusion efforts.

REPORT STRUCTURE

The structure of this report is as outlined below:

Chapter 1 gives the contextual background of the survey. It outlines the objectives and scope of the survey.

Chapter 2 outlines the survey methodology and approaches that were used in gathering survey data.

Chapter 3 is a critical review of existing literature on de-risking, extent, causes and impact to the financial sector.

Chapter 4 presents survey analysis and discussion of findings.

Chapter 5 provides recommendations and conclusion.

CHAPTER ONE - INTRODUCTION

1.1 Background of the Survey

1. The financial sector plays a pivotal role in any economy through facilitation of international transactions settlement amongst other functions. This process happens through the establishment of banking relationships in various countries known as correspondent banking. The increased focus on AML/CFT regulatory compliance in recent years has not only increased the compliance costs for financial institutions but has also increased pressure to ensure compliance in order to avoid penalties. As a result, providers of CBRs have reduced or terminated relationships with respondent institutions which were considered to be of high risk. Consequently, the termination of relationships has also extended to customers of these financial institutions.

2. The Financial Action Task Force (FATF) has defined de-risking as a phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risks in line with the FATF's risk-based approach (RBA). Irrespective of the underlying reasons for de-risking, there is concern because of the increasing risk of financial transactions which are likely to take place through less or non-regulated channels. In effect, this may reduce transparency over financial flows and counteract efforts to reduce financial exclusion. Inevitably, exposure to Money Laundering and Terrorist Financing (ML/TF) risks will also increase. Furthermore, the loss of CBRs makes it difficult to make cross-border payments which can potentially threaten the stability of the financial system.

3. In view of these adverse consequences and pursuant to the September 2016 ESAAMLG meetings in Victoria Falls, Zimbabwe, the Council of Ministers approved a survey on de-risking focusing on ESAAMLG member countries.

1.2 Problem Statement

4. De-risking has become a worldwide phenomenon and there is an emerging body of literature on the subject. However, there has been no specific survey conducted to determine the existence, extent, causes and impact of de-risking in ESAAMLG member countries. De-risking has adverse effects on both the financial sectors and customers in member countries. In the case of financial institutions, de-risking deprives them of CBRs which are necessary for the smooth performance of the settlement of international transactions. Furthermore, anecdotal evidence indicates de-risking practices will likely result in further isolation of vulnerable communities, particularly, from the formal financial sector and may have wide ranging humanitarian, economic and security implications. Where financial institutions are denied access to CBRs, they in turn de-risk certain segments of their customers in order to comply with the AML/CFT requirements thereby excluding some customers from the financial system. Another challenge posed by de-risking is that transactions conducted by the excluded segments are no longer within the scrutiny of financial institutions and relevant regulators as they are now part of the informal sector. This creates a conducive breeding ground for illicit financial flows within a country's economy and may increase money laundering prospects in an already unregulated segment. In view of these challenges, ESAAMLG considered it necessary to undertake a survey to assess the existence, extent, causes and impact of de-risking in the region.

1.3 Objectives of the Survey

5. The objectives of the survey were as follows:

(i) To determine the existence, nature and extent of the changing trends in de-risking within the ESAAMLG region;

(ii) To establish the drivers of de-risking in countries within the ESAAMLG region;

(iii) To assess the impact of de-risking in countries within the ESAAMLG region; and how they have responded to the phenomenon;

(iv) To examine the impact of de-risking on financial inclusion efforts; and

(v) To suggest appropriate recommendations.

1.4 Scope of the Survey

6. The survey targeted both the private and public sector players including but not limited to banking, insurance, securities, co-operative societies, Money or Value Transfer Services (MVTS), forex bureaus and financial sector regulators in all 18 ESAAMLG member countries. The survey covered the period January 2011 to June 2016.

CHAPTER TWO - RESEARCH DESIGN AND METHODOLOGY

2.1 Introduction

7. This chapter presents the research design and methodology used to collect data. It outlines the design of the data collection instrument and limitations of the survey.

2.2 Survey Approach

2.2.1 Methodology

8. Following the ESAAMLG Council of Ministers' resolution at its 16th meeting held in Victoria Falls, Zimbabwe in September 2016, the Task Force of Senior Officials established a Project Team comprising five countries to conduct a survey on de-risking. To facilitate the collection of data, the team designed and adopted a questionnaire which was circulated to all member countries.

9. The questionnaire was administered to both private and public financial sector players through their regulatory authorities. A total of 633 completed questionnaires were received and all questionnaires were considered. In addition, the team conducted a review of literature to augment the survey responses. The survey used MS Excel for data analysis and presentation of graphs and tables.

2.2.2 Limitations

10. In conducting the survey, several limitations were noted as follows:

    (i) While several institutions responded to the questionnaires, some of the responses were incomplete and inconsistent. In some cases, no responses were provided. Furthermore, some of the respondents did not provide any information for fear of breaching confidentiality and secrecy provisions in their countries' respective laws.

    (ii) The survey relied on questionnaire responses without recourse to other methods of verifying the accuracy of the responses. This was so despite the survey team taking comfort in the fact that a separate questionnaire was administered to financial sector regulators, and therefore, it was possible to augment the responses to the questionnaires to some extent.

(iii) There were delays in data capturing and analysis due to lack of appropriate software analytical tools which made the exercise onerous.

CHAPTER THREE - LITERATURE REVIEW

3.1 Introduction

11. This chapter reviews related literature on the extent, drivers and impact of de-risking. It first focuses on the definitions of de-risking before delving into core causes and effects including its impact on financial inclusion. Further, it addresses the measures being undertaken by countries and financial institutions to mitigate the impact of de-risking.

12. Various organizations conducted studies on de-risking and these include the International Monetary Fund (IMF), World Bank, FATF and Global Centre on Cooperative Security, amongst others. The studies were mainly focused on the impact of de-risking on CBRs, money service businesses (MSBs), foreign embassies and non-profit organizations (NPOs) as well as providing a set of recommendations about how interested stakeholders can better address de-risking challenges.

3.2 Definition of De-risking

13. Durner and Shetret (2015) defined *"De-risking," or "de-banking," as the practice of financial institutions exiting relationships with and closing the accounts of clients perceived to be "high risk."* A broader and more authoritative definition is provided by the FATF as, *"a phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risk in line with the FATF's risk-based approach".*

14. According to the IMF (2015), correspondent banking relationship is a bilateral arrangement, often involving a reciprocal cross-border relationship in multiple currencies whereby one bank (the *correspondent*) provides a deposit account or other

liability accounts, and related services, to another bank (the *respondent*), often including its affiliates.

15. These relationships facilitate a range of transactions and services including the execution of third-party payments, trade finance, the banks' own cash clearing, liquidity management and short-term borrowing or investment needs in a particular currency. Correspondent banking services are therefore essential to enabling companies and individuals to transact internationally and make cross-border payments.

3.3 Drivers of De-risking

16. Based on the WB (2015) findings, the key drivers of the decline in CBRs were broadly divided into two. Some banks terminated CBRs purely because they did not find the relationship to be cost effective. On the other hand, another strand of banks severed the relationships on account of ML/TF risks which they could not manage and fear of AML/CFT enforcement by international/regional regulators. The two drivers could be considered conjointly in view of the fact that higher risk may result in greater cost. While local/regional banks put more emphasis on the economic/business rationale for the decline, banking authorities and large banks emphasized both regulatory AML/CFT and business-related concerns. The WB noted that terminating CBRs may lead to the unintended consequence of driving higher risk customers out of regulated institutions thereby increasing the overall ML/TF risk or excluding legitimate customers. However, the survey was not able to conclusively establish this fact.

17. Studies carried out by IMF (2016) and Durner and Shetret (2015) showed the drivers of de-risking as perceived or assessed risk on respondent banks, significant compliance costs, regulatory obligations and enhanced enforcement including economic and trade sanctions. Other drivers included AML/CFT requirements, anti-bribery and tax evasion regulations, United Nations Security Council Resolutions (UNSCRs) targeted financial sanctions, client profitability, reputational concerns and enhanced corporate and

individual accountability. Artingstall et al (2016) concluded from a survey conducted in the UK that banks are lowering their overall profile to realign their business and are paying closer attention to compliance in the aftermath of the global financial crisis. Moreover, banks have stated that de-risking is partly a result of the higher costs of compliance and the increased amount of regulatory capital now required and partly a response to criminal, civil and regulatory actions. These include regulatory settlements such as Deferred Prosecution Agreements (DPAs) especially those reached in response to AML/CFT failings.

18. The WB carried out a survey to assess the status of de-risking phenomenon in the G-20 countries with particular focus on the drivers and its impact on international MVTS providers. The survey involved 13 G-20 countries, 25 banks and 82 MVTS providers (World Bank, 2015a). The WB established existence of de-risking and noted an increasing trend on the number of accounts being closed or restricted. At the time of the survey, more closures were in the pipeline.

19. Furthermore, the survey found that the main drivers for MVTS account closure were: (i) profitability, (ii) pressure from other actors (correspondent banks) and fear of regulatory scrutiny, (iii) lack of confidence in the MVTS procedures, and (iv) reputational risk. The survey also observed that the banks and MVTS providers did not cite AML/CFT-related violations or sanctions by MVTS as one of the top 5 reasons for account closures. There are very few MVTS providers (principals or agents) that were fined, suspended, sanctioned or received some other enforcement action for an AML/CFT-related violation between 2012 and 2014.

3.4 Impact of De-risking

20. The WB survey established that banking authorities and local/regional banks were experiencing a decline in CBRs. The decline was most prominent in large international banks, and the Caribbean was reported to be the most severely affected. The US was found to be the top jurisdiction where foreign CBRs (nostros) were terminated or

restricted. Other jurisdictions that terminated or restricted CBRs included United Kingdom (UK), France, Germany, Canada, Italy and Spain. In particular, the survey reported that the withdrawal of correspondent banking mostly affected cheque clearing and settlement, cash management services, international wire transfers and, for banking authorities, local/regional banks and trade finance. In terms of currency, the withdrawal was significant in transactions denominated in US dollars (USD) followed by Euro, pound sterling (GBP), and Canadian dollar (CAD) denominated transactions. In addition, the survey found that majority of money transfer operators and other remittance companies were the most affected, followed by small and medium domestic banks and small and medium exporters, retail customers, international business companies, and e-gaming/gambling (World Bank, 2015).

21. However, in the last six years or so, there have been reports that certain large international banks have started terminating or severely limiting their CBRs with smaller local and regional banks from jurisdictions around the world. In view of these developments, the WB carried out a survey in 2015 involving 110 banking authorities, 20 large banks, and 170 smaller local and regional banks in order to examine the extent of withdrawal from correspondent banking, its drivers, and its implications for financial exclusion/inclusion (World Bank, 2015b).

22. According to *IMF (2016)*, there was evidence regarding the withdrawal of CBRs and it was found that there is pressure on CBRs in some parts of the world and that smaller jurisdictions in Africa, the Caribbean, Central Asia, and Europe have been most affected. The withdrawal of CBRs also appears to have affected certain categories of customers and business lines. According to the results of the surveys undertaken by the IMF and Union of Arab Banks (UAB) and Association of Supervisors of Banks of America (ASBA) (2015), MVTS, small and medium-sized exporters, and small and medium-sized domestic banks have been the most affected categories of customers. In addition, international wire transfers, clearing and settlement services and trade finance appear to have been particularly affected (World Bank 2015b).

23. The studies further highlighted the impact of de-risking as: (i) having an adverse humanitarian and security implications or socio-economic stability for example Somalia; (ii) increased vulnerability by pushing high-risk clients to smaller financial institutions that may lack adequate AML/CFT capacity, or even out of the formal financial sector altogether; (iii) created unintended consequences for financial inclusion goals; (iv) ambiguity of regulatory frameworks, coupled with a lack of empirical information about de-risking criteria, has allowed responsibility for addressing the problem to shift continually among stakeholders. De-banked customers are left without clear expectations and unable to anticipate and protect themselves against impending account closures; (v) public relations repercussions, since banks are seen as cutting off crucial funds to vulnerable populations.

24. As a further impact of the de-risking phenomenon, a significant portion of MVTS providers could no longer access banking services. In order to maintain their presence in the market some MVTS providers had to use alternative channels to clear and settle the amounts at international level by (i) using other MVTS providers, (ii) operating via cash management companies and physically transporting cash, and (iii) using personal bank accounts. In the receiving countries, the reduction of access to the bank accounts for the agents led to higher operational and compliance risks and costs to the MVTS providers which would ultimately be transferred to the customers.

25. The WB (2015) survey involved nine of the ESAAMLG member countries and within the countries, responses were poor. For this purpose, member countries resolved to carry out a broader survey focusing on de-risking in general, involving all member countries and more sub-sectors of the financial sector.

CHAPTER FOUR - DATA ANALYSIS AND FINDINGS

4.1 Extent and Impact of De-risking

26. The survey sought to examine the extent of termination and restriction of customer accounts/ relationships conducted by financial institutions from the following three different perspectives over the period 2011 - 2015:

a) **Risk Perception:** Terminations and restrictions attributed to the perception of risk inherent in the customer relationship for all the financial sectors that participated in the survey. As part of this, the survey examined the terminations and restrictions associated with the following categories perceived as being high risk:

- Customers;
- Jurisdictions; and
- Products, services, transactions or delivery channels.

b) **Compliance with Customer Due Diligence requirements:** This examined the terminations associated with:

- Incomplete customer due diligence; and
- Customer concerns, including inability to identify the beneficial owner or interested party, payment transparency and source of funds/wealth

c) **Terminations and Restrictions associated with CBRs:** This section of the survey only focused on the banking sector examining responses of both respondent and correspondent banks.

4.1.1 *Terminations and Restrictions arising from Risk Perception*

27. Financial institutions were asked to indicate reasons for terminations/ restrictions on account of unacceptable levels of ML/TF risk inherent in certain (i) customers, (ii) jurisdictions and (iii) products, services, transactions or delivery channels.

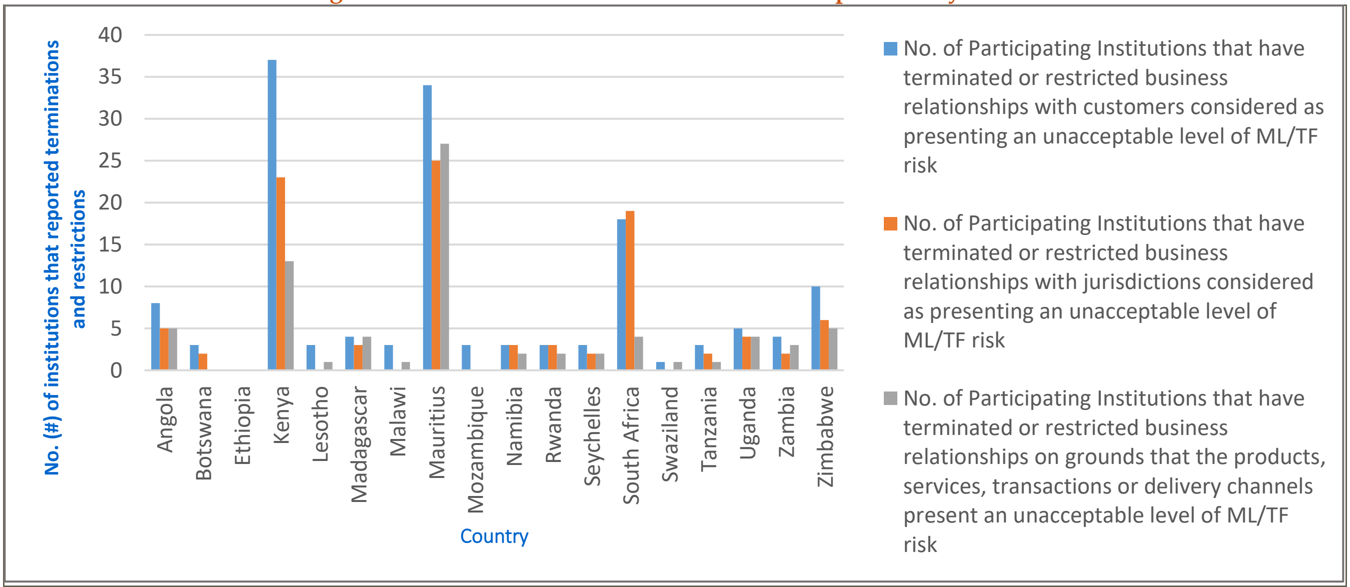
(i) 45% of the institutions indicated that they had terminated/restricted business relationships with customers considered as presenting an unacceptable level of ML/TF risk;

(ii) 31% of institutions indicated that they had terminated/ restricted business relationships with jurisdictions considered as presenting an unacceptable level of ML/TF risk; and

(iii) 24% of institutions indicated that they had terminated/ restricted business relationships on the grounds that the products, services, transactions or delivery channels presented an unacceptable level of ML/TF risk.

28. Countries that reported the highest levels of terminations and restrictions were Kenya, Mauritius and South Africa as depicted in Figure 1 below.

Figure 1: Extent of terminations and restrictions per country



29. At a sectoral level, terminations/ restrictions were reported across all sectors except the retirement benefits sector which reported no terminations. The banking sector reported

the highest number of terminations. In total, 84 banks terminated relationships with high risk customer groups, 49 banks terminated relationships with high risk jurisdictions and 40 banks terminated relationships on account of high risk products, services, transactions or delivery channels. The other financial sector segment that was impacted by terminations was the off-shore management sector based in Mauritius. In total, 26 institutions terminated relationships with high risk customer groups, 19 institutions terminated relationships with high risk jurisdictions and 21 institutions terminated relationships on account of high risk products, services, transactions or delivery channels. Table 1 below summarizes the number of institutions that reported terminations across various customer segments.

Table 1: Number of Institutions that reported terminations across various customer segments depicted per sector

Customer type	Banking	Capital Markets	Co-operative Society	Forex Bureau	Insurance	Micro-finance	MVTS	Offshore Mgt. Co.	Retirement Benefits	Total
Affected Customer Groups										
Customers from/ doing business in high risk countries	48	10	1	3	6	5	0	19	0	**92**
Customers with negative publicities	46	6	1	2	5	1		13	1	**75**
PEPs	22	6	2	4	7	1	1	11	1	**55**
Non-resident customers	18	7	2	5	2	0	1	7	0	**42**
Forex Bureaus	29	5	0	4	1	0	0	1	0	**40**
Non-face-to-face business relationships/ transactions	14	6	0	4	4	0	0	8	0	**36**
Cash intensive businesses	22	4	0	0	3	0	0	5	0	**34**
Money Value Transfer Services (MVTS)	23	2	0	1	1	0	1	0	0	**28**
Customers with complex ownership structures	15	3	0	1	4	0	0	4	0	**27**
Non-Profit Organizations (NPOs)	18	1	0	1	1	0	0	0	0	**21**
Private Banking customers	11	2	0	0	0	0	2	1	0	**16**
Customers who are Public/ State bodies or entities	9	2	0	1	0	0	0	1	0	**13**
Total	**275**	**54**	**6**	**26**	**34**	**7**	**5**	**70**	**2**	**479**

Table 2 below summarizes the number of institutions that reported terminations across various products.

Table 2: Number of Institutions that reported terminations across various products

Products	Banking	Capital Markets	Co-operative Society	Forex Bureau	Insurance	Micro-finance	MVTS	Offshore Mgt. Co.	Retirement Benefits	Total
Affected Products										
Remittances/ wire transfer products to certain jurisdictions	26	2	1	1	1	0	1	2	0	**34**
Correspondent banking accounts/ relationship	21	3	1	0	1	0	0	2	0	**28**
Trade Finance products to certain jurisdictions	19	1	0	0	0	0	0	1	0	**21**
Investment banking/ offshore accounts	12	6	0	0	0	0	0	1	0	**19**
Total	**78**	**12**	**2**	**1**	**2**	**0**	**1**	**6**	**0**	**102**

30. Trends in terminations/ restrictions reported over the period 2011 – 2015 showed that customers perceived as being high risk were most affected by terminations over the years. The banking sector accounted for 99% of terminations/ restrictions over the period 2011 – 2015. The majority of terminations/ restrictions occurred in South Africa. The country accounted for 98.8% of terminations/ restrictions over the period 2011 – 2015. Table 3 below summarizes the number of terminations in (i) customers, (ii) jurisdictions and (iii) products, services, transactions or delivery channels over the period 2011- 2015.

Table 3: Number of terminations reported between Year 2011 - Year 2015

YEAR	REASON FOR TERMINATION/ RESTRICTION		
	# of Terminations/ restrictions for customers considered as presenting an unacceptable level of ML/TF risk	# of Terminations/ restrictions for jurisdictions considered as presenting an unacceptable level of ML/TF risk	# of Terminations/ restrictions for products, services, transactions or delivery channels presenting an unacceptable level of ML/TF risk
YR 2011	84,067	39	102
YR 2012	91,488	81	50
YR 2013	91,831	85	53
YR 2014	86,039	124	1,315
YR 2015	119,124	71	58
TOTAL	**472,549**	**400**	**1,578**

4.1.2 *Terminations and Restrictions arising from Customer Due Diligence Compliance requirements*

31. Financial institutions were asked to confirm whether remediation efforts conducted on their customers with regards to customer due diligence were conducted as a result of requirements placed on them either by their bank or correspondent bank. Out of the 601 institutions, only 43 institutions (7%) responded that remediation was conducted as a result of requirements by their bank or correspondent bank. Out of these 43 institutions, 74% were institutions in the banking sector. The capital markets, co-operative society, forex bureau, insurance and MVTS sectors reported very few incidences where remediation was conducted as a result of requirements placed on them by their bank. None of the institutions in the micro-finance, offshore management companies and retirement benefits sectors reported having conducted remediation as a result of requirements by their bank. Few of the participating institutions had readily available data on the precise period when the remediation exercise was conducted with a view to terminate/ restrict customer relationships. Only 19 institutions i.e. 18 banks and one institution in the capital markets had data on this.

32. From this available data:

    (i) In South Africa, three banks reported having conducted remediation exercises over the period 2014 – 2016. One bank reviewed all its CBRs in 2015 while another took a decision in 2016 to terminate all relationships perceived as being high risk. One bank focused its remediation efforts on 25 banks in Angola and Zimbabwe over the period 2013 – 2015.

(ii) In Kenya, 9 banks conducted remediation exercises though the period when this was conducted was not clear. One bank reported that due to the high risk nature of forex bureaus, money value transfer businesses, casinos and gambling institutions, it suspended on-boarding new relationships with the mentioned entities from 2015. Existing relationships were not terminated but the services provided were limited to avoid breaching correspondent bank requirements. Another bank reported terminating a customer relationship for a cash intensive business for failing to provide supporting documentation. One bank reported termination as a result of a suspicious transaction conducted by their customer. Yet another bank reported having conducted a de-risking exercise on MVTS in 2012 and on specific financial institutions in 2014.

(iii) In Zambia, two banks reported having conducted remediation exercises in 2013 and 2016.

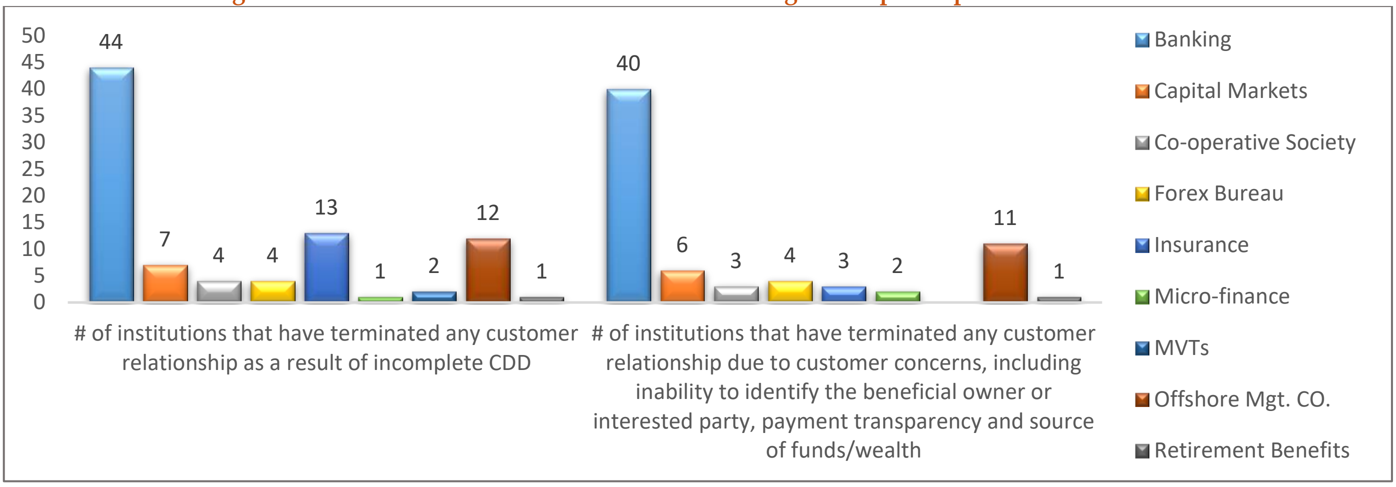
(iv) In Zimbabwe, one bank reported that it had terminated relationships with certain customers due to the ML/TF risk perceived by its correspondent banks. The affected customers were in the gambling sector and one dealer in ammunition. The bank reported that the correspondent bank indicated that transactions for the affected customers should not be facilitated through their Nostro account. However, the bank clarified that the decision to terminate was not "dictated" by the correspondent but the bank decided to terminate the relationship to preserve its relationship with the correspondent bank as it was not able to control incoming transactions associated with the affected customers. One institution in the capital markets sector reported terminations associated with gambling customers and an ammunition dealer.

(v) In Madagascar, one bank reported termination where a customer failed to provide information on source of funds. Another reported terminations where customers were associated with the illegal exportation of rosewood over the period 2010 – 2015.

4.1.2.1 Terminations

33. Incomplete customer due diligence (CDD) - *"Reason A"* and customer concerns, including inability to identify the beneficial owner or interested party, payment transparency and source of funds/wealth- *"Reason B"*- were identified as key issues that led to termination of customer relationships. Of the 601 participating institutions, 88 institutions (15%) in total terminated relationships as a result of Reason A, while another 70 institutions (11%) terminated relationships due to Reason B. Most of the terminations for both Reasons A and Reason B occurred in the banking sector as reported by 44 institutions (50%) and 40 institutions (57%) respectively. The other financial sectors reported significantly lower levels of termination for both Reason A and Reason B. No terminations were reported by the MVTS sector on account of Reason B. Figure 2 shows terminations per sector.

Figure 2: Terminations related to Customer Due Diligence depicted per sector



34. At country level, Kenya reported the highest number of institutions that have terminated customer relationships as a result of Reason A. South Africa and Mauritius also reported a high number of institutions that had terminated customer relationships

as a result of Reason A. On the other hand, no institution in Ethiopia, Lesotho and Swaziland reported that it had terminated customer relationships as a result of Reason A. Similarly, for Reason B, Kenya reported the highest number of institutions that had terminated customer relationships. South Africa and Mauritius also reported a high number of institutions that had restricted customer relationships as a result of Reason B. On the other hand, no institution in Botswana, Ethiopia, Lesotho, Mozambique and Swaziland reported that it had terminated customer relationships as a result of Reason B.

Table 4 below shows the number of institutions that reported terminations for Reason A and Reason B for the period 2011 – 2015 and the level of termination relative to total number of customers.

Table 4: Terminations trend for the period 2011-2015

Level of Termination	Reason A: # of Institutions conducting terminations on account of incomplete customer due diligence (CDD)					Reason B: # of Institutions conducting terminations on account of customer concerns, including inability to identify the beneficial owner or interested party, payment transparency and source of funds/wealth				
	Yr. 2011	**Yr. 2012**	**Yr. 2013**	**Yr. 2014**	**Yr. 2015**	**Yr. 2011**	**Yr. 2012**	**Yr. 2013**	**Yr. 2014**	**Yr. 2015**
No terminations	72	67	109	54	48	52	52	48	43	37
Less than 10%	33	40	52	48	57	17	19	93	85	105
10-20%	-	-	1	2	3	1	1	-	3	5
Over 20%	1	2	1	-	-	-	-	-	-	2
Total	**106**	**109**	**163**	**104**	**108**	**70**	**72**	**141**	**131**	**149**

4.1.3 Terminations and Restrictions associated with Correspondent Banking Relationships (CBRs)

4.1.3.1 Denial of CBRs on account of AML/CFT Concerns

35. In the ESAAMLG region, 24 respondent banks reported that they had been denied corresponding banking services by another bank on account of AML/CFT concerns. This denial of CBRs affected multiple countries i.e. Angola (5 banks), South Africa and Zimbabwe (4 banks each), Tanzania (3 banks) and Seychelles (2 banks). Kenya, Madagascar, Mauritius, Rwanda, Swaziland and Zambia each had one bank that was affected by denial of CBRs. The currencies that were most affected by terminations were USD, EUR, AUD and GBP.

4.1.3.2 Termination and Restriction of CBRs

36. A total of 78 respondent banks in the ESAAMLG region indicated that CBRs had been terminated or restricted between the periods 2011 to 2016. The reasons for the terminations and restrictions were varied including, but not limited to, AML/CFT concerns. Table 5 below summarizes the total number (#) of respondent banks that have experienced termination or restriction of CBRs between the periods 2011 to 2016.

Table 5: Total # of respondent banks that have experienced termination or restriction of CBRs since Year 2011

Country	Category			Total # of respondent banks that have experienced any termination or restriction of CBRs since Year 2011
	# affected by both Termination and Restrictions	# affected by Restrictions	# affected by Terminations	
Angola	2	6	5	**13**
Botswana	-	-	2	**2**
Kenya	2	3	8	**13**
Lesotho	-	-	1	**1**
Madagascar	-	1	2	**3**
Malawi	-	-	3	**3**
Mauritius	-	-	3	**3**
Mozambique	-	1	1	**2**
Namibia	-	-	1	**1**
Rwanda	1	1	3	**5**
Seychelles	-	-	3	**3**
South Africa	2	1	4	**7**
Swaziland	-	-	1	**1**
Tanzania	-	-	7	**7**
Uganda	-	-	2	**2**
Zambia	-	-	3	**3**
Zimbabwe	-	-	9	**9**
Total	**7**	**13**	**58**	**78**

37. A total of 108 CBR accounts were affected by terminations or restrictions between the periods 2011 to 2016. During this period, 89 CBR accounts were affected by terminations while 19 CBR accounts were affected by restrictions. This is summarized in Table 6 below:

Table 6: Total number of terminations or restrictions in CBR accounts between 2011 and 2016

Country	# of Termination (T)/ Restriction (R) in the respective Year												Total # of Termination and Restriction 2011 - 2016	
	Year 2011		Year 2012		Year 2013		Year 2014		Year 2015		Year 2016			
	T	R	T	R	T	R	T	R	T	R	T	R	T	R
Angola	0	0	0	1	0	1	1	0	3	4	3	1	**7**	**7**
Botswana	0	0	2	0	0	0	0	0	0	0	0	0	**2**	**0**
Kenya	0	0	1	0	3	1	4	1	4	1	5	3	**17**	**6**
Lesotho	0	0	0	0	1	0	0	0	1	0	0	0	**2**	**0**
Madagascar	0	0	0	0	0	0	1	0	0	1	1	0	**2**	**1**
Malawi	0	0	1	0	1	0	2	0	1	0	2	0	**7**	**0**
Mauritius	0	0	0	0	0	0	0	0	0	0	3	0	**3**	**0**
Mozambique	0	0	0	0	0	0	0	0	1	0	0	0	**1**	**0**
Namibia	0	0	0	0	0	0	1	0	0	0	0	0	**1**	**0**
Rwanda	0	0	1	0	0	0	2	0	0	0	1	2	**4**	**2**
Seychelles	0	0	0	0	0	0	2	0	2	0	0	0	**4**	**0**
South Africa	1	0	0	0	0	0	0	0	0	2	11	1	**12**	**3**
Swaziland	0	0	0	0	0	0	1	0	0	0	0	0	**1**	**0**
Tanzania	0	0	1	0	1	0	4	0	1	0	2	0	**9**	**0**
Uganda	0	0	0	0	0	0	0	0	0	0	2	0	**2**	**0**
Zambia	0	0	1	0	0	0	0	0	1	0	1	0	**3**	**0**
Zimbabwe	1	0	1	0	2	0	1	0	1	0	6	0	**12**	**0**
Total	**2**	**0**	**8**	**1**	**8**	**2**	**19**	**1**	**15**	**8**	**37**	**7**	**89**	**19**

38. In response to terminations or restrictions respondent banks would adopt two main response strategies:

    (i) Find a replacement correspondent bank; or

    (ii) Establish alternative arrangements e.g. use of another respondent bank's nostro account.

    It should be noted that since some banks had more than one CBR terminated or restricted, a combination of the two strategies would be adopted i.e. for some CBRs, the respondent bank would find a replacement CBR but for another CBR, the respondent bank would make alternative arrangements.

    From the survey, eleven respondent banks reported having failed to find a replacement CBR or make alternative arrangements.

Table 7 below summarizes the various responses and also compares the ease and cost of establishing replacement CBRs.

Table 7: Responses to terminations and restrictions

Country	Responses to terminations and restrictions (# of respondent banks)			Ease of establishing replacement CBR (# of respondent banks)			Cost of establishing replacement CBR (# of respondent banks)		
	# of banks that found replacement correspondent bank	# of banks that established alternative arrangements	# of banks that were unable to find replacement or alternative arrangements	Very easy with more than 3 options to choose from	Fairly easy but with less than 3 options to choose from	Difficult-multiple rejections before finally finding a replacement CBR	Cost was lower	Cost was more or less the same	Cost was significantly higher
Angola	9	6	1	1	7	3	2	5	3
Botswana	2	-	-	-	2	-	-	2	-
Kenya	9	2	1	1	8	1	2	4	4
Lesotho	1	-	-	-	-	-	-	-	-
Madagascar	2	1	-	-	1	-	-	1	-
Malawi	1	3	-	-	2	-	1	1	-
Mauritius	3	1	-	-	3	-	-	3	-
Mozambique	1	-	-	1	-	-	-	1	-
Namibia	1	-	-	-	1	-	-	-	-
Rwanda	4	-	1	2	2	-	2	2	-
Seychelles	1	2	-	-	-	2	-	1	1
South Africa	7	-	-	-	3	3	-	2	4
Swaziland	-	-	1	-	-	-	-	-	-
Tanzania	3	2	3	-	2	2	1	1	1
Uganda	1	2	1	1	-	-	-	1	-
Zambia	1	1	1	1	-	1	1	-	1
Zimbabwe	5	1	2	1	2	3	1	3	3
Total	**51**	**21**	**11**	**8**	**33**	**15**	**10**	**27**	**17**

39. The notice period given to the correspondent banks before termination or restriction of CBR varied. Whereas the majority of the banks were provided with a notice period, the below should be noted:

    (i) Four banks were provided with no notice period. The banks are located in Kenya (2 banks) and one bank each in Malawi and Tanzania;

(ii) Three banks were provided with a notice period of less than 10 days. The three banks are located in Angola, Kenya and Madagascar; and

(iii) Six other banks (i.e. excluding those in (ii) above were provided with a notice period of 30 days. The banks are located in Angola (1 bank), Kenya (1 bank), Rwanda (2 banks) and Zimbabwe (2 banks).

Table 8 below compares the notice period given before termination or restriction of CBRs against the actual time taken to find a replacement CBR.

Table 8: Comparison between the notice period given before termination or restriction of CBRs against the actual time taken to find a replacement CBR

Country	# of Banks given the respective notice period by the Correspondent Bank				# of Banks that spent the respective time below finding replacement CBRs			
	0 - 3 months	3 - 6 months	6 - 9 months	> 9 months	0 - 3 months	3 - 6 months	6 - 9 months	> 9 months
Angola	9	-	-	-	6	4	1	-
Botswana	0	-	-	-	2	-	-	-
Kenya	18	2	1	1	7	1	1	1
Lesotho	1	-	-	-	-	-	-	-
Madagascar	1	-	-	-	1	-	-	-
Malawi	2	-	-	-	2	-	-	-
Mauritius	2	-	-	-	3	-	-	-
Mozambique	0	-	-	-	1	-	-	-
Namibia	1	-	-	-	1	-	-	-
Rwanda	5	-	-	-	2	1	-	-
Seychelles	2	-	-	-	2	1	-	-
South Africa	6	-	-	-	2	3	-	1
Swaziland	1	-	-	-	-	-	-	-
Tanzania	7	-	-	-	1	1	-	1
Uganda	1	-	-	-	2	-	-	-
Zambia	3	-	-	-	2	-	-	-
Zimbabwe	9	-	-	-	4	2	-	-
Total	**68**	**2**	**1**	**1**	**38**	**13**	**2**	**3**

40. Out of the 51 banks that were able to find replacement CBRs, 14 banks reported that there were additional terms and conditions for the new CB:

(i) Six banks reported that there were newly imposed minimum thresholds below which the account would be closed;

(ii) Three banks reported that there was a new requirement to exit certain types of customers;

(iii) Three banks reported that there was imposition of KYCC ("Know Your Customer's Customer") requirements;

(iv) Three banks reported that there was a new restriction/ prohibition on payable through accounts; and

(v) Four banks reported that there was new restriction/ prohibition imposed on nested accounts.

4.1.3.3 Changes in the flow of payments

41. A total of 107 banks reported that they started depending on two or less than two correspondent banks for processing of more than 75% of their transactions as a result of the termination and/or restriction of CBRs. At the same time, 32 banks reported that their correspondent banking arrangements had changed since January 2014 in such a way that payments were flowing through different countries or types of correspondent banks due to conditions/restrictions imposed by their key correspondent bank. This change in the flow of payments impacted various countries i.e. Kenya (9 banks), Angola (7 banks), South Africa (4 banks,) Tanzania (3 banks), Zimbabwe (3 banks), Madagascar, Malawi, Mozambique, Seychelles, Swaziland, Zambia affecting 1 bank in each country.

4.1.3.4 Customer groups affected by termination/ restriction of foreign CBRs

42. Since January 2011, 24 respondent banks reported having conducted termination of customer accounts in response to conditions imposed by correspondent banks. This analysis is depicted in Table 9 below:

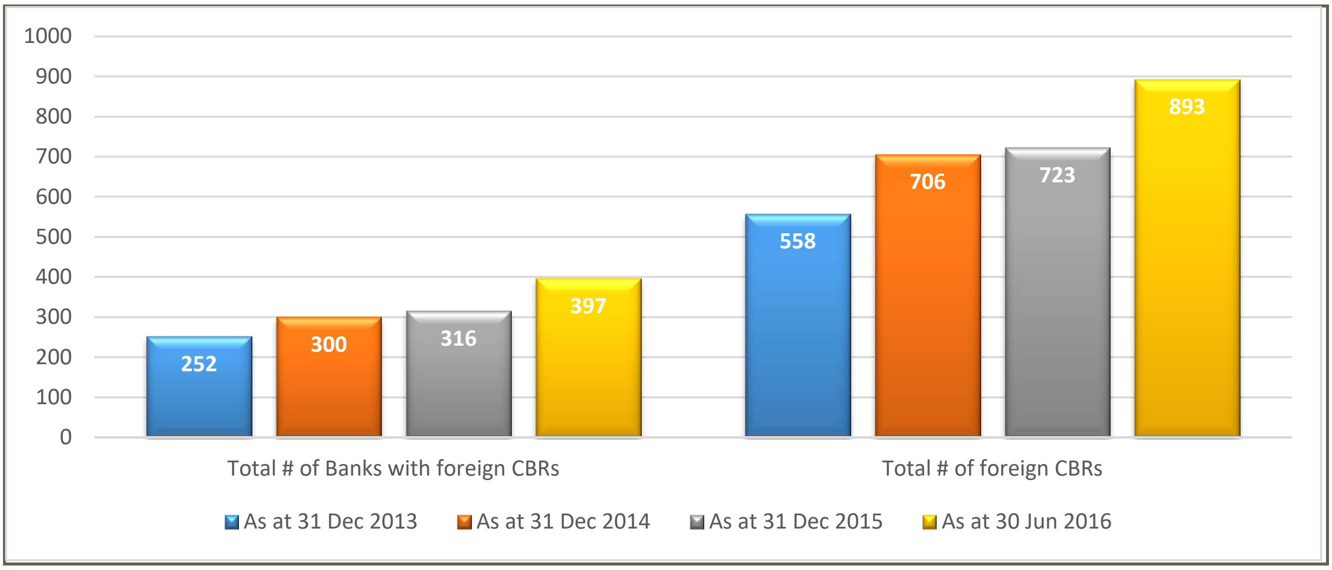
Table 9: Terminations of specific customer groups in response to conditions imposed by correspondent banks

Customer Group	# of Institutions reporting terminations			Affected Countries
	Terminated "FEW" customers	Terminated "MAJORITY" of customers	Terminated "ALL" customers	
Non-Profit Organizations (NPOs)	2	0	3	Angola, Kenya, South Africa, Zimbabwe
Money Value Transfer Services (MVTS) Provider	6	0	2	Angola, Kenya, Mauritius, Rwanda, South Africa, Zimbabwe
Another financial institution	5	0	1	Kenya, South Africa, Zimbabwe
Forex Bureau	2	1	2	Kenya, Zimbabwe
Politically exposed person (PEPs)	1	1	0	Kenya, Zimbabwe
Embassies	1	0	1	Kenya, Zimbabwe
Customers/ transactions from certain countries	4	1	2	Angola, Kenya, Seychelles, Zimbabwe
Businesses that are cash intensive	2	1	0	Kenya, Zimbabwe
Public/ State bodies or entities	0	1	0	Zimbabwe
Refugees	0	0	1	Zimbabwe
Gambling entities including casinos, online casinos, betting companies and lotteries	1	0	4	Kenya, Malawi, Seychelles, Zimbabwe
Dealers in high-value precious goods, for example, jewel, gem and precious metal dealers, art and antique dealers, auction houses	1	0	0	Angola
Entities involved in the defense industry e.g. suppliers of military weapons, ammunition, equipment, and stores.	1	0	2	Kenya, Zimbabwe

4.1.3.5 Changes in number of foreign CBRs

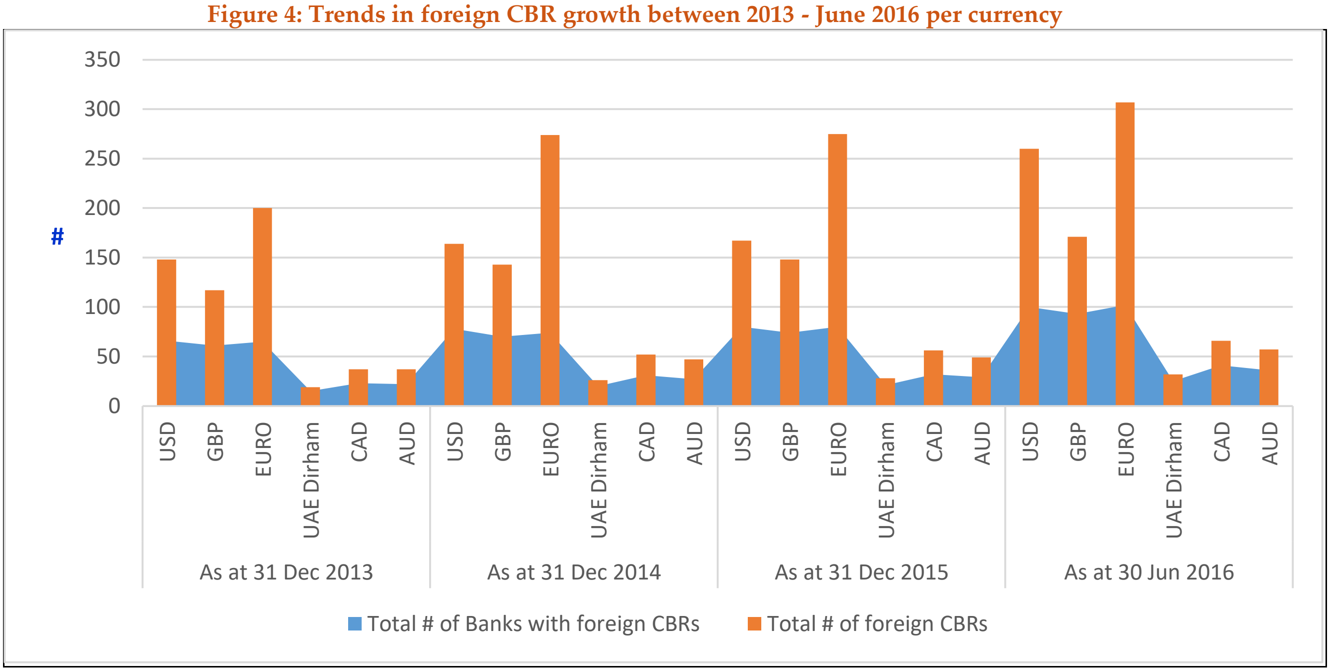
43. From the analysis, it was established that the total number of banks with foreign CBRs increased by 37% between 2013 and June 2016 while the total number of foreign CBRs increased by 38% over the same period. It should however be noted that these numbers may be understated as some banks did indicate that the historical data was not readily available. However, though there is no evidence that the number of foreign CBRs has reduced over the period 2013 to June 2016, the rate of growth in foreign CBRs as well as number of banks with foreign CBRs dropped significantly and stagnated over the period 2014 to 2015.

Figure 3: Trends in foreign CBR growth between 2013 - June 2016



The trends over the period per currency are presented below:

Figure 4: Trends in foreign CBR growth between 2013 - June 2016 per currency



4.2 Impacts of de-risking as observed by Regulators/ Authorities

44. The Regulators/ Authorities provided feedback on the general impact of de-risking on remittances and on financial inclusion. The data analysis was however conducted at country level as Regulators/ Authorities supervising multiple sectors did not provide

specific details per sector. This limited the extent to which the data analysis could be conducted.

4.2.1 *General impacts of de-risking observed by Regulatory Authorities*

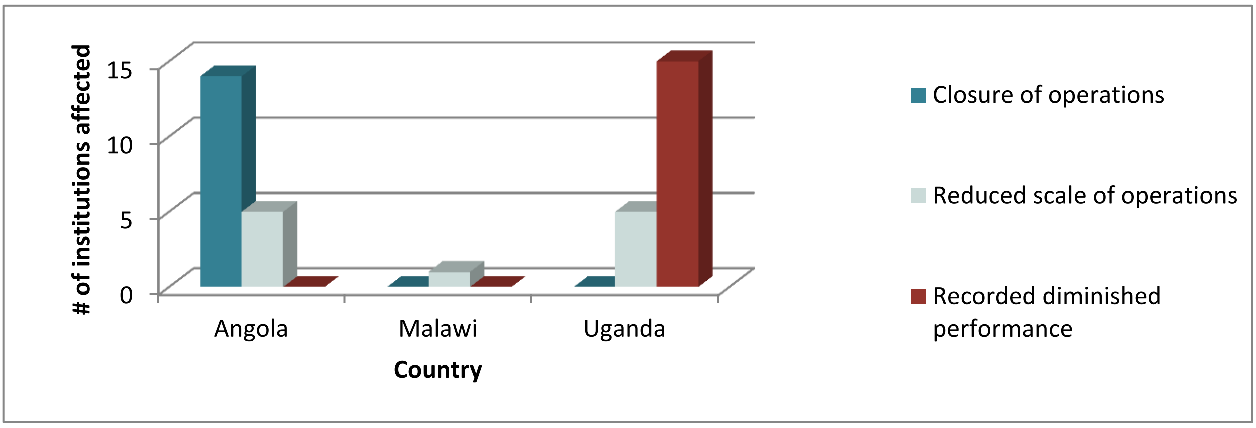
45. An aggregate of 15 Regulatory Authorities in Angola, Botswana, Kenya, Malawi, Namibia, South Africa, Swaziland, Tanzania, Uganda and Zimbabwe, reported that their financial sectors had been negatively impacted by de-risking. The impacts on the financial sectors included termination of relationships, denial of service, restriction in products and services and termination of services for specific customer groups within the sector. These are summarized in Table 10 below:

Table 10: Summary of de-risking impacts observed in ESAAMLG countries

Countries where the financial sectors have been impacted by de-risking through terminations	Countries where the financial sectors have been impacted by de-risking denial of service	Countries where the financial sectors have been impacted by de-risking through restriction in products and services	Countries where the financial sectors have been impacted by de-risking through termination of services for specific customer groups within the Sector
Angola, Botswana, Kenya, Malawi, Namibia, South Africa, Swaziland, Tanzania, Uganda and Zimbabwe	Kenya, Malawi, Swaziland, Uganda and Zimbabwe	Angola, Botswana, South Africa, Uganda and Zimbabwe	Angola, Botswana, Kenya, South Africa, Uganda and Zimbabwe

46. Five jurisdictions namely Angola, Botswana, Malawi, Uganda and Zimbabwe indicated that de-risking had resulted in closure of operations, reduced scale of operations or recorded diminished financial performance. A total of 40 institutions in the financial sectors were affected by de-risking in this regard. These are summarised in Figure 5 below though Botswana and Zimbabwe did not provide the exact number of institutions that had been impacted.

Figure 5: Number of Institutions in the ESAAMLG region that were affected by de-risking



47. Five jurisdictions namely Angola, Kenya, Tanzania, Uganda and Zimbabwe indicated that as a result of de-risking growth in their financial sectors over the period January 2014 - June 2016 had been negatively impacted. The types of impact reported by the countries are summarized in Table 11 below:

Table 11: Impact on financial sectors experienced over the period January 2014 - June 2016

Country	Types of Impacts that have been experienced over the period January 2014 - June 2016						
	Reduction in number of applications for licensing of new institutions	Reduction in financial sectors' asset size	Reduction in the number of Sectoral players who are foreign institutions	Difficulty in accessing international payment systems and foreign markets for trade	Exclusion of certain customer groups from access to the products and services	Loss of jobs	Reduction in financial flows to the Sector/ economy
Angola	-	-	Yes	Yes	Yes	-	-
Kenya	-	-	Yes	-	Yes	-	-
Tanzania	-	-	-	Yes	-	-	-
Uganda	Yes	-	-	Yes	Yes	-	Yes
Zimbabwe	-	Yes	-	Yes	-	Yes	Yes

48. Six jurisdictions namely Angola, Botswana, Kenya, Tanzania, Uganda and Zimbabwe indicated that some types of customer groups had been impacted by de-risking. The extent of the impact varied from low to significant impact as summarized in Table 12 below:

Table 12: Impact of de-risking on various customer groups

Country	Customer Group							
	Money Value Transfer Services (MVTS) Provider	Another financial institution	Forex Bureau	Politically exposed person (PEPs)	Customers/ transactions from certain countries	Businesses that are cash intensive	Public/ State bodies or entities	Gambling entities including casinos, online casinos, betting companies and lotteries
Angola	Low	-	Moderate	Low	Moderate	Significant	-	-
Botswana	Low	-	-	-	-	-	-	-
Kenya	Moderate	-	Moderate	-	Moderate	-	-	-
Tanzania	-	Moderate	-	-	Significant	-	-	-
Uganda	Significant	Moderate	Significant	-	Significant	-	-	Moderate
Zimbabwe	Moderate	Moderate	Moderate	Moderate	Moderate	-	Moderate	-

49. Angola provided further details of the impact on some customer groups as follows:

- Investment banking/ offshore accounts – Low impact
- Customers with negative publicities – Moderate impact
- Non-resident customers – Moderate impact
- Clients where the ownership structure of a company appears unusual or excessively complex given the nature of the company business – Low impact

4.2.2 *Impact of de-risking on remittances*

50. The survey sought to examine the impact of de-risking on remittance flows as well as understand how the jurisdictions regulate the remittances sector.

Size of the Remittances Sector:

51. Eleven jurisdictions reported having money remittance/ money value transfer service providers. Angola, Botswana, Kenya, Madagascar, Malawi, Namibia, Swaziland, Uganda and Zimbabwe reported that they had less than 20 remittance providers while Tanzania reported that it had between 50 – 100 providers. These numbers do not include the number of money remittance/ money value transfer service agents.

Regulation of the Remittances Sector:

52. For the jurisdictions with money remittance/ money value transfer service providers, the Regulatory Authorities indicated that all providers required to be licensed/ registered before conducting business. With the exception of Malawi, Rwanda and Swaziland the requirements for licensing/ registration also extend to agents of the money remittance/ money value transfer service providers. Further, with the exception of Malawi and Madagascar, supervisory frameworks of the Regulatory Authorities extend to both money remittance/ money value transfer service providers and their agents. As part of this supervisory framework, Regulatory Authorities in Kenya, Namibia, Tanzania and Uganda indicated that they had applied sanctions on money remittance/ money value transfer service providers or their agents.

De-risking in the Remittances Sector

53. Five jurisdictions namely Angola, Botswana, Tanzania, Uganda and Zimbabwe indicated that money remittance/ money value transfer service providers or their agents had been subjected to de-risking. However, the Regulatory Authorities indicated that the extent of impact was low affecting less than 10% of money remittance/ money value transfer service providers or their agents. In 3 jurisdictions namely Tanzania, Uganda and Zimbabwe, the de-risking of money remittance/ money value transfer service providers or their agents had resulted in a reduction in remittance flows. However, the Regulators/ Authorities indicated that the extent of impact was low affecting less than 10% of money remittance/ money value transfer service providers or their agents' transactions.

4.2.3 *Impact of de-risking on financial inclusion*

54. The survey sought to examine the impact of de-risking on financial inclusion as well as understand the various financial inclusion products present in the jurisdictions.

Overview of Financial Inclusion in the ESAAMLG region

55. Across 10 jurisdictions namely Botswana, Kenya, Madagascar, Malawi, Namibia, South Africa, Swaziland, Tanzania, Uganda and Zimbabwe reported having a financial inclusion strategy policy. For Angola, financial inclusion is a priority agenda though there is no financial inclusion strategy policy in place. The jurisdictions indicated that access to financial products and services is considered to be a challenge to the general public.

56. The Regulatory Authorities indicated that their respective jurisdictions offer different types of financial inclusion products/ services as indicated in Table 9 below:

Table 13: Financial Inclusion products/services in the ESAAMLG region

Financial Inclusion Product/Service					
Access to bank accounts	Access to remittance products	Access to micro-loans	Access to pension/ retirement planning schemes	Access to micro-insurance	Access to investment options/ plans
Angola, Botswana, Ethiopia, Kenya, Madagascar, Malawi, Namibia, Rwanda, South Africa, Swaziland, Tanzania, Uganda and Zimbabwe	Botswana, Ethiopia, Kenya, Madagascar, Malawi, Namibia, Rwanda, South Africa, Swaziland, Tanzania, Uganda and Zimbabwe	Angola, Botswana, Kenya, Madagascar, Malawi, Namibia, Rwanda, South Africa, Tanzania, Uganda and Zimbabwe	Botswana, Kenya, Malawi, Namibia, Rwanda, South Africa and Zimbabwe	Botswana, Kenya, Malawi, Namibia, Rwanda, South Africa, Swaziland, Uganda and Zimbabwe	Botswana, Kenya, Malawi, Namibia, Rwanda, South Africa and Zimbabwe

Impact of de-risking on Financial Inclusion

57. Nine jurisdictions namely Angola, Botswana, Kenya, Malawi, Namibia, South Africa, Tanzania, Uganda and Zimbabwe indicated that they consider de-risking to be a threat to financial inclusion. Furthermore, eight jurisdictions namely Angola, Botswana, Kenya, Malawi, Namibia, Tanzania, Uganda and Zimbabwe indicated that de-risking had negatively impacted specific customer types/ groups' access to financial inclusion products/ services. This is depicted in Table 14 below:

Table 14: Customer groups impacted by de-risking from a financial inclusion perspective

Country	Impact on various customer types or groups																							
	NPOs			MVTS			Forex Bureau			PEPs			Customers from high risk countries			Public/ State bodies and entities			Refugees & undocumented immigrants			Retirees/ elderly persons		
	L	M	S	L	M	S	L	M	S	L	M	S	L	M	S	L	M	S	L	M	S	L	M	S
Angola	-	-	-	Yes	-	-	-	Yes	-	Yes	-	-	-	-	Yes	-	-	-	-	-	-	-	-	-
Botswana	-	-	-	-	-	-	-	-	-	-	-	Yes	Yes	-	-	-	-	-	-	-	Yes	-	-	-
Kenya	-	Yes	-	-	Yes	-	-	Yes	-	-	-	Yes	-	Yes	-	-	Yes	-	Yes	-	-	Yes	-	-
Malawi	-	-	-	-	-	-	-	-	-	Yes	-	-	-	Yes	-	Yes	-	-	-	Yes	-	-	-	-
Namibia	-	-	-	-	-	-	-	-	-	-	-	-	-	-	Yes	-	-	-	-	-	-	-	-	-
Tanzania	-	-	-	-	-	-	-	-	-	-	-	-	-	-	Yes	-	-	-	-	-	-	-	-	-
Uganda	-	-	-	-	-	Yes	-	-	Yes	-	-	-	-	-	Yes	-	-	-	-	-	-	-	-	-
Zimbabwe	-	-	-	-	Yes	-	-	-	-	-	Yes	-	-	Yes	-	-	Yes	-	-	-	-	-	-	-
N/B	**"L" denotes Low, "M" denotes Medium and "S" denotes Significant**																							

58. The nature of impact caused by de-risking was classified into three categories as below:

Table 15: Nature of impacts caused by de-risking from a financial inclusion perspective

Countries where the specific customer groups have been impacted by de-risking through terminations	Countries where the specific customer groups have been impacted by de-risking through denial of service	Countries where the specific customer groups have been impacted by de-risking through re-pricing of services provided
Angola, Botswana, Namibia, Uganda and Zimbabwe	Botswana, Kenya, Malawi, Tanzania, Uganda and Zimbabwe	Malawi

59. Three jurisdictions namely Botswana, Kenya and Zimbabwe indicated that over the period January 2014 to June 2016, there was a shift from the formal financial sector to informal financial channels as a result of de-risking.

60. Six jurisdictions namely Botswana, Kenya, Malawi, Tanzania, Uganda and Zimbabwe indicated that de-risking had negatively impacted access to financial inclusion products and services. The financial inclusion products and the extent to which they were affected by de-risking is depicted in Table 16 below:

Table 16: Extent to which financial inclusion products/ services were impacted by de-risking

Country	Financial Inclusion Products or Services																	
	Access to bank account			Access to remittance products			Access to micro-loans			Access to pension or retirement planning			Access to micro-insurance			Access to investment options or plans		
	L	M	S	L	M	S	L	M	S	L	M	S	L	M	S	L	M	S
Botswana	-	-	-	Yes	Yes	-	-	-	Yes	-	-	-	-	-	-	-	-	-
Kenya	-	Yes	-	-	-	-	Yes	-	-	Yes	-	-	Yes	-	-	Yes	-	-
Malawi	Yes	-	-	Yes	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Tanzania	-	-	-	-	-	Yes	-	-	-	-	-	-	-	-	-	-	-	-
Uganda	-	-	Yes	Yes	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Zimbabwe	-	Yes	-	-	Yes	-	-	Yes	-	-	Yes	-	-	Yes	-	-	-	Yes
N/B	**"L" denotes Low, "M" denotes Medium and "S" denotes Significant**																	

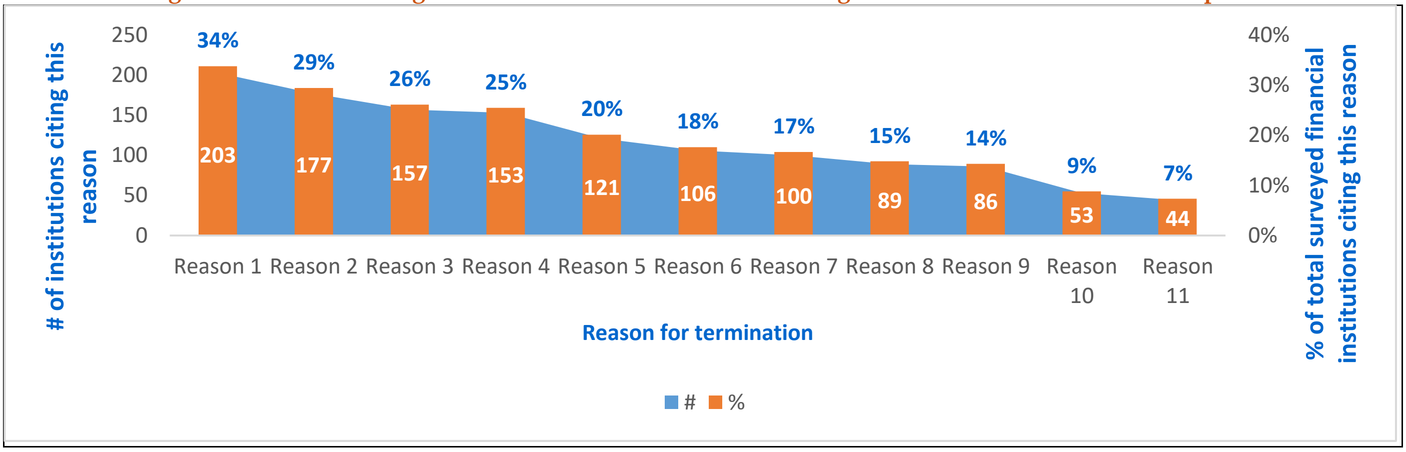
4.3 Causes of De-risking

4.3.1 *Reasons driving Terminations and Restrictions of customer relationships*

61. Financial institutions were asked to indicate reasons that drove/ influenced their decisions to terminate/ restrict customer relationships. A set of 11 options were provided and as seen from the below, the need to conform was the primary driver of terminations/ restrictions.

62. The survey showed that 34% of the financial institutions conducted terminations/ restrictions as a means of conforming to regulatory obligations so as to avoid sanctions and reputational damage. On the same note, 29% of the participating institutions conducted terminations/ restrictions as a means of conforming to correspondent banking requirements on customer due diligence. Cost did not feature among the top reasons for termination/ restriction of customer accounts. As such only 15% of participating institutions conducted terminations/ restrictions as a result of increased cost of doing business, 14% as a result of increased cost of compliance and 9% as a result of concerns over profitability.

Figure 6: Reasons driving terminations and restrictions affecting the overall customer relationship



Key

Reason 1	Need to conform to regulatory enforcement obligations to avoid sanctions and reputational damage
Reason 2	To conform to AML/CFT requirements on correspondent banking and customer due diligence (where ML/TF risks cannot be mitigated, in line with proper implementation of risk-based approach)
Reason 3	Geographic areas prone to ML, or terrorist financing or subject to sanctions
Reason 4	Reluctant or un-cooperative customers
Reason 5	Firms operating in high-risk environments such as countries subject to international sanctions
Reason 6	Reaction to actions by other institutions or competitors (e.g. withdrawal from certain higher risk customers in a specific sector when competitors are pulling out)
Reason 7	To forestall possible criminal proceeding against the institution and senior management of the institution
Reason 8	Increased cost of doing business
Reason 9	Increased cost of Compliance
Reason 10	Concerns over profitability
Reason 11	Perception that the internal controls of another financial institution were weak

63. Sectoral analysis shows that the need to conform to requirements on correspondent banking and customer due diligence was the main reason for terminations/ restrictions in the banking and capital markets sector. In the offshore management, insurance, forex bureau, co-operative society and micro-finance sectors, the main reason was the need to conform to regulatory enforcement actions. In the MVTS sector, the need to conform to requirements on correspondent banking and customer due diligence as well as actions taken by competitors to withdraw from certain high risk sectors were the main reasons for terminations/ restrictions. Table 17 summarizes the 11 reasons for termination showing percentage of financial institutions in that sector that cited a particular reason for termination.

Table 17: Reasons for termination/ restriction showing % of institutions per sector

Sector	Reason 1	Reason 2	Reason 3	Reason 4	Reason 5	Reason 6	Reason 7	Reason 8	Reason 9	Reason 10	Reason 11
Banking	47%	49%	36%	39%	31%	25%	23%	21%	25%	11%	13%
Capital Markets	27%	34%	23%	19%	12%	29%	13%	18%	13%	8%	4%
Offshore Mgt. CO.	36%	16%	31%	27%	25%	4%	18%	5%	7%	7%	9%
Insurance	32%	9%	28%	16%	19%	6%	16%	17%	16%	16%	3%
MVTS	6%	24%	4%	6%	3%	24%	4%	4%	3%	6%	3%
Forex Bureau	40%	13%	17%	37%	20%	3%	23%	10%	7%	7%	7%
Co-operative Society	30%	22%	19%	19%	15%	11%	11%	15%	15%	4%	4%
Micro-finance	36%	21%	29%	21%	21%	0%	14%	14%	7%	7%	7%
Retirement Benefits	50%	0%	25%	50%	25%	0%	25%	0%	0%	0%	0%

64. The analysis shows that as much as requirements on correspondent banking were a significant reason driving terminations, terminations across the sectors, categories of institutions and countries were influenced by a combination of reasons.

4.3.2 *Terminations and restrictions within the correspondent banking relationship*

65. The respondent banks in the ESAAMLG region highlighted several reasons as the causes/ drivers of foreign financial institutions' decisions to terminate or restrict foreign CBRs. These reasons were grouped into four main categories as follows:

a) **Reasons attributed to global dynamics namely:**
   - Impact of internationally agreed financial regulatory reforms (other than AML/CFT) (e.g. capital requirements).

b) **Reasons attributed to changes in the correspondent bank's jurisdiction/ policies namely:**
   - Overall risk appetite of the correspondent bank;
   - Lack of profitability of certain foreign CBR services/products;
   - Changes to legal, regulatory or supervisory requirements in the correspondent banks that have implications for maintaining CBRs;

- Compliance with pre-existing legal/ supervisory / regulatory requirement by the correspondent bank; and
- Structural changes to the correspondent bank (including merger/acquisition) and/or reorganization of business portfolio.

c) **Reasons attributed to concerns on the respondent bank's jurisdiction namely:**

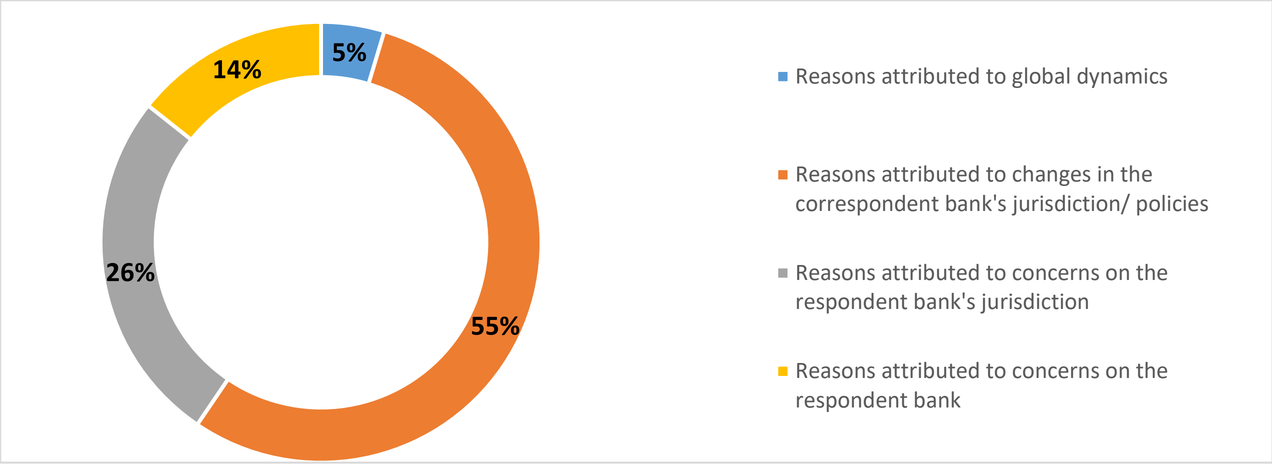
- Concerns about money laundering/terrorist financing risks within the jurisdiction;
- The jurisdiction is subject to countermeasures or identified as having strategic AML/CFT deficiencies by FATF (or another international body);
- Imposition of international sanctions on the jurisdiction;
- Industry consolidation among the correspondent banks providing CBR services;
- Imposition of enforcement actions by the domestic authority of the relevant foreign financial institution relating to the jurisdiction; and
- The sovereign credit risk rating of the jurisdiction.

d) **Reasons attributed to concerns on the respondent bank namely:**

- Inability/ cost for foreign financial institutions to undertake CDD on the respondent bank's customers (KYCC);
- The respondent bank's high-risk customer base;
- The respondent bank has been sanctioned for lack of compliance with AML/CFT or sanctions regulations; and
- Concerns or insufficient information about, the respondent bank's CDD procedures (for AML/CFT or sanction purposes).

66. Figure 7 below depicts the four broad categories of terminations and shows that reasons attributed to changes in the correspondent bank's jurisdiction/ policies were the leading causes/ drivers of terminations of foreign CBRs accounting for 55% of responses.

Figure 7: Causes of terminations and restrictions of foreign CBRs in the four broad categories



67. Table 18 shows a breakdown of each of the reasons for termination. From this, it is clear that decreasing risk appetite by the correspondent banks was the primary reason for terminations/ restrictions affecting 30% of respondents.

Table 18: Causes/ drivers of terminations and restrictions of foreign CBRs per individual reason

REASON FOR TERMINATION/ RESTRICTION		# of Banks	% of total respondents
Reasons attributed to global dynamics	Impact of internationally agreed financial regulatory reforms (other than AML/CFT) (e.g. capital requirements)	11	7%
Reasons attributed to changes in the correspondent bank's jurisdiction/ policies	Overall risk appetite of the correspondent bank	48	30%
	Lack of profitability of certain foreign CBR services/products	28	17%
	Changes to legal, regulatory or supervisory requirements in the correspondent banks' jurisdiction that have implications for maintaining CBRs	26	16%
	Compliance with pre-existing legal/ supervisory / regulatory requirement by the correspondent bank	15	9%
	Structural changes to the correspondent bank (including merger/acquisition) and/or reorganization of business portfolio	13	8%
Reasons attributed to concerns on the respondent bank's jurisdiction	Concerns about money laundering/terrorism financing risks in the jurisdiction	20	12%
	The jurisdiction is subject to countermeasures or identified as having strategic AML/CFT deficiencies by FATF (or another international body)	12	7%
	Imposition of international sanctions on the jurisdiction	12	7%
	Industry consolidation among the correspondent banks providing CBR services	7	4%
	Imposition of enforcement actions by the domestic authority of the relevant foreign financial institution relating to the jurisdiction	6	4%
	The sovereign credit risk rating of the jurisdiction	5	3%
Reasons attributed to concerns on the	Inability/ cost for foreign financial institutions to undertake CDD on the respondent bank's customers (KYCC)	15	9%

respondent bank	The respondent bank's high-risk customer base	7	4%
	The respondent bank has been sanctioned for a lack of compliance with AML/CFT or sanctions regulations	6	4%
	Concerns about, or insufficient information about, The respondent bank's CDD procedures (for AML/CFT or sanction purposes)	6	4%

4.4 Measures adopted to mitigate ML/TF Risks in the Region

68. The Literature Review conducted showed that a section of correspondent banks terminated relationships on account of ML/TF risks which they could not manage and for fear of AML/CFT sanctions that can be applied by international/regional regulators. Taking into account this concern, the survey sought to examine the extent to which specific measures have been taken by financial institutions and regulators to combat ML/ TF risks in their jurisdictions in line with the FATF recommendations.

4.4.1 *Measures taken by financial institutions*

4.4.1.1 Measures related to FATF Recommendations on obligations to assess risks and apply a risk based approach

69. The survey established that 543 out of the 601 institutions that participated in the survey had conducted institutional risk assessments. This represents 90% of the surveyed institutions with financial institutions in all 18 ESAAMLG being represented. Of the participating 601 financial institutions, 91% indicated that they updated their risk assessments at a defined frequency. Though the frequency of update varied as shown below, the highly preferred frequencies were annually and event based. 53 institutions did not have a defined frequency for updating their risk assessment. Majority of the 53 institutions, are in the insurance and capital market sectors i.e. 37% (20 institutions) and 28% (15 institutions) respectively. Table 19 provides a summary of the foregoing.

Table 19: Practices related to Institutional Risk Assessment depicted per Financial Sector

Country	Conduct of Institutional ML/TF Risk Assessment			Frequency of update to Institutional ML/TF Risk Assessment							
	# conducted	# not conducted	# not indicated	Annually	Event Based	Quarterly	Monthly	Semi-annually	Annually and Event Based	Semi-annually and Event Based	Not defined/ not indicated
Banking	168	10	1	96	49	12	6	8	2	1	5
Capital Markets	108	9	2	28	39	8	14	7	4	4	15
Co-operative Society	27	3	-	3	22	1	2	-	-	-	2
Forex Bureau	61	5	3	23	25	7	6	-	-	-	8
Insurance	71	19	1	20	27	13	10	1	-	-	20
Micro-Finance	12	1	1	5	3	2	2	1	-	-	1
MVTS	25	1	1	8	12	2	1	3	-	-	1
Offshore Mgt. Co.	67	1	-	29	11	13	3	12	-	-	-
Retirement Benefits	4	-	-	1	1	1	-	-	-	-	1
Total (#)	**543**	**49**	**9**	**213**	**189**	**59**	**44**	**32**	**6**	**5**	**53**
Total (%)	**90%**	**8%**	**1%**	**35%**	**31%**	**10%**	**7%**	**5%**	**1%**	**1%**	**9%**

4.4.1.2 Measures related to FATF Recommendations on Customer Due Diligence

70. **Customer Acceptance Policies (CPAs)**

Over 93% of financial institutions indicated that they have established Customer Acceptance Policies. The contents of the Customer Acceptance Policies were found to be largely similar when compared amongst the various countries, sectors and types of institutions. However, when the Customer Acceptance Policies were compared across countries, some weaknesses were noted. For Mozambique, only 33% of the financial institutions indicated they had customer acceptance policies. Several countries namely Ethiopia, Malawi, Mozambique, Swaziland and Tanzania had a low percentage of financial institutions that had included prohibitions on the establishment of customer relationships where KYC assessment could not be completed in their customer acceptance policies. At sectoral level, it was observed that the customer acceptance policies of MVTS (52%) and Capital Market (25%) sectors did not expressly prohibit the establishment of customer relationships where KYC assessment could not be completed.

Table 20: Comparison of Customer Acceptance Policies adopted by the various sectors

Financial Sector	Institutions with CAP (%)	Contents of the Customer Acceptance Policy (CAP) (%)							
		CAP specifies KYC rqmts. and stds	CAP prohibits relationships where KYC cannot be completed	CAP specifies customer risk assessment parameters	CAP addresses how to deal with PEPs	CAP prohibits dealing with shell banks	CAP requires confirmation of identity and sources of funds during on-boarding	CAP prohibits opening of accounts/ dealing with customers with anonymous or fictitious name(s)	CAP prohibits dealing with customers who are sanctioned by the United Nations
Banking	95%	98%	87%	98%	98%	98%	98%	98%	98%
Capital Markets	95%	99%	75%	99%	99%	99%	99%	99%	99%
Co-operative Society	97%	100%	97%	100%	100%	100%	100%	100%	100%
Forex Bureau	88%	100%	100%	100%	100%	100%	100%	100%	100%
Insurance	87%	93%	92%	95%	92%	92%	93%	92%	93%
Micro-finance	100%	100%	100%	100%	100%	100%	100%	100%	100%
MVTS	96%	100%	48%	100%	100%	100%	100%	100%	100%
Offshore Mgt. Co.	97%	100%	100%	100%	100%	100%	100%	100%	100%
Retirement Benefits	100%	100%	100%	100%	100%	100%	100%	100%	100%

Compliance Programmes

71. As depicted in Table 21 below, 85% of the institutions (513 institutions) reported having established AML/CFT compliance programs. However, as depicted in Table 22, no significant change in total budget allocation for AML/CFT programs was noted over the 5 year period 2011- 2015. This picture was replicated across all the financial sectors. The bulk of the institutions spent less than 5% of overall institutional budgets on AML/CFT programs. Table 23 shows how total investment in AML/ CFT compliance has changed over the last three years.

Table 21: Establishment of AML/CFT Programs

Financial Sector	Total Institutions	Institutions with a program		Institutions without a program		Institutions that did not respond	
		Number	%	Number	%	Number	%
Banking	179	167	93%	2	1%	10	6%
Capital Markets	119	103	87%	8	7%	8	7%
Co-operative Society	30	29	97%	1	3%	-	0%
Forex Bureau	69	51	74%	7	10%	11	16%
Insurance	91	68	75%	15	16%	8	9%
Micro-Finance	14	11	79%	2	14%	1	7%
MVTS	27	16	59%	3	11%	8	30%
Offshore Mgt Co.	68	64	94%	2	3%	2	3%
Retirement Benefits	4	4	100%	-	0%	-	0%
Grand Total	**601**	**513**		**40**		**48**	

Table 22: Overall Budget allocation 2011 - 2015

Year	Less than 5%		5-10%		10-15%		Over 15%	
	Number	(%)	Number	(%)	Number	(%)	Number	(%)
Yr. 2011	293	49%	52	9%	6	1%	11	2%
Yr. 2012	296	49%	46	8%	11	2%	14	2%
Yr.2013	306	51%	52	9%	10	2%	19	3%
Yr. 2014	308	51%	61	10%	13	2%	22	4%
Yr. 2015	329	55%	68	11%	13	2%	25	4%

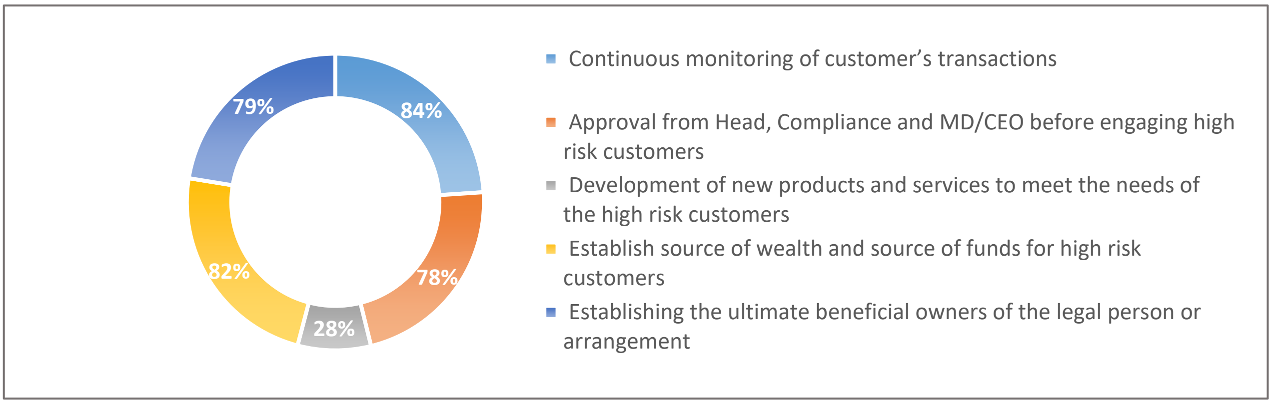
Table 23: Total investment changes in AML/CFT compliance over the last three years

Financial Sector	Change in total investment in AML/CFT compliance over the last three years				
	Decrease in total investment	No change in real terms	Less than 25% increase	25-50% increase	Over 50% increase
Banking	1%	8%	30%	8%	18%
Capital Markets	0%	24%	25%	9%	5%
Co-operative Society	0%	27%	23%	17%	10%
Forex Bureau	1%	19%	20%	4%	6%
Insurance	0%	48%	19%	3%	4%
Micro-Finance	0%	14%	29%	7%	7%
MVTS	0%	30%	7%	0%	0%
Offshore Mgt Co.	1%	26%	28%	12%	7%
Retirement Benefits	0%	50%	25%	0%	0%

4.4.1.3 Measures related to FATF Recommendations on higher risk countries

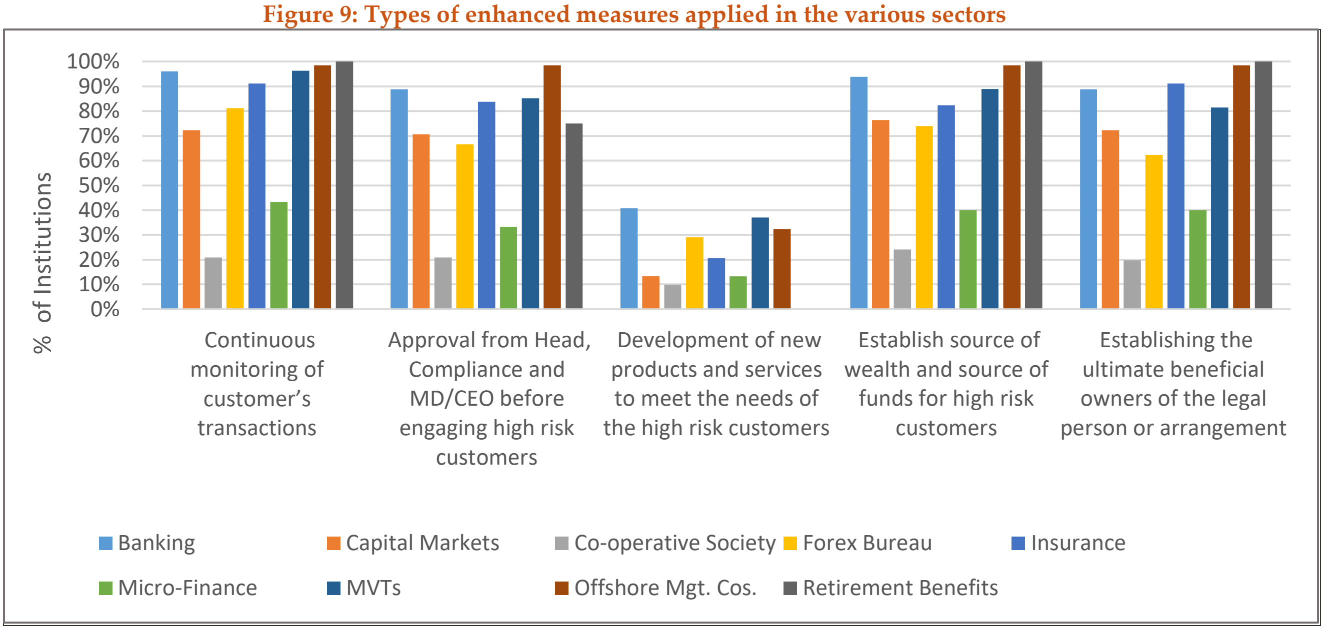
72. Of the total financial institutions that participated in the survey, 531 institutions (88%) indicated that they apply enhanced measures in respect of high risk customers or transactions with customers in countries designated as high risk. These enhanced measures are broadly summarized in Figure 8 below:

Figure 8: Enhanced measures applied as a percentage of total institutions surveyed



The enhanced measures applied in each of the financial sectors are summarized in Figure 9 below:

Figure 9: Types of enhanced measures applied in the various sectors



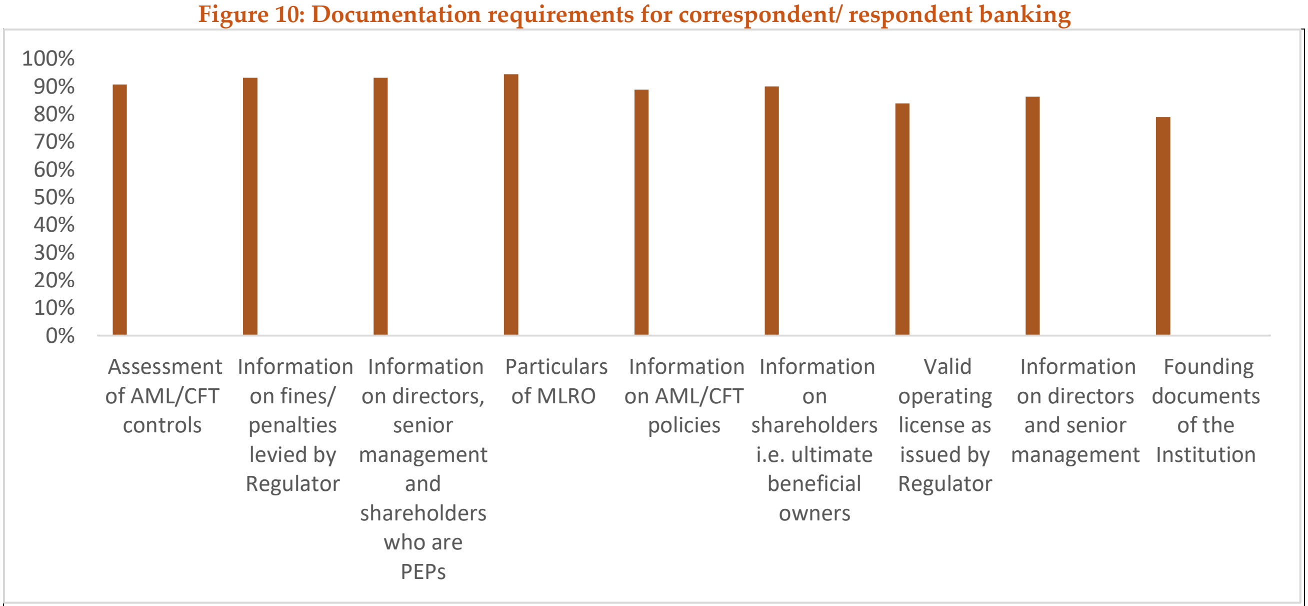
4.4.1.4 *Measures related to FATF Recommendations on wire transfers*

73. Respondent banks indicated that international wire transfers were made in USD, GBP, EUR, CHF, ZAR, JPY, AED and INR currencies. Results of the survey showed that 36% of the banks made less than 25% of their payments directly to a correspondent bank in the jurisdiction where the account of the beneficiary of the transfer was held.

74. The banks also indicated that they conduct screening of transactions. In conducting the screening, 56% relied on automated systems while 44% were screening the transactions manually. 15% were using a combination of both manual and automated systems.

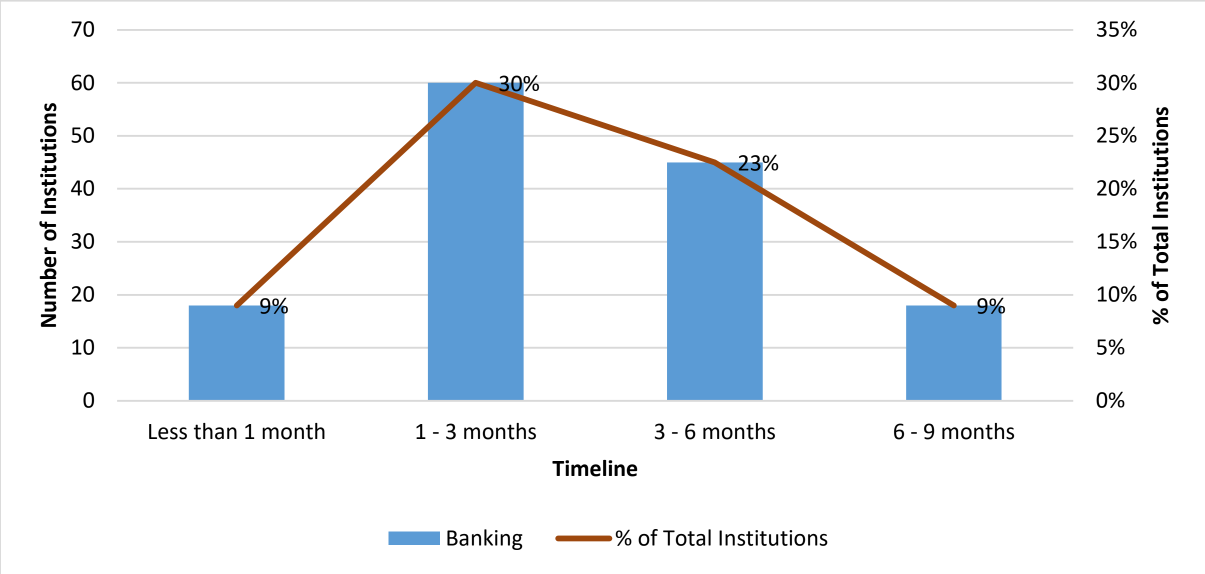
75. When establishing correspondent/ respondent relationships, the banks conducted enhanced due diligence that entailed provision of the documentation/ information depicted in Figure 10 below:

Figure 10: Documentation requirements for correspondent/ respondent banking



76. Only 30% of the institutions, mostly banks, indicated that the establishment of correspondent relationships took 1 – 3 months.

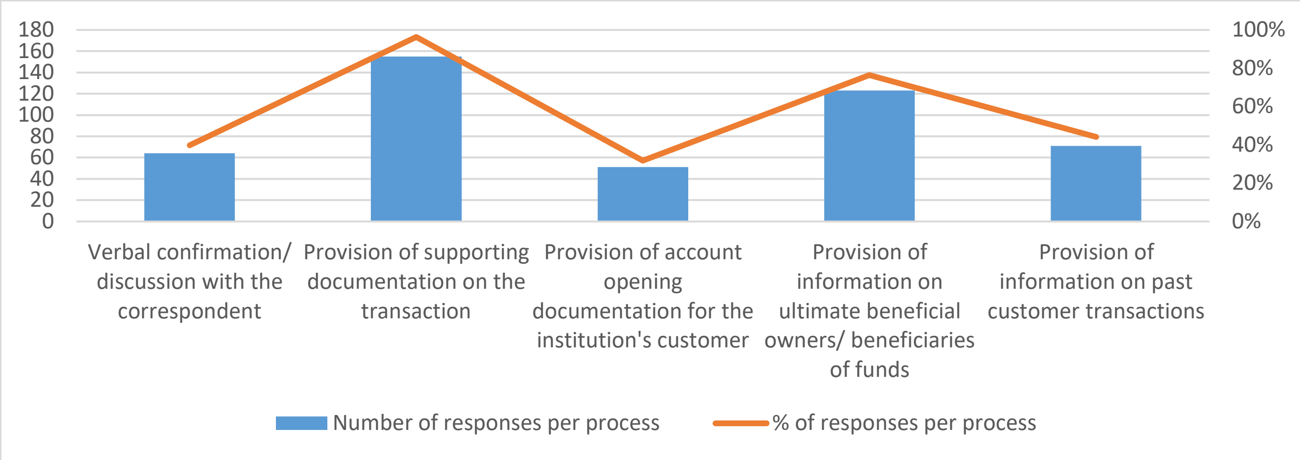
Figure 11: Time taken to establish a CBR



77. **Queries from Correspondent Banks**

The large majority of the respondent banks indicated that less than 10% of their transactions were queried by the correspondent banks. The queries were related to sources of funds, beneficial ownership and reasons for payment. In response to queries received from correspondent banks, the respondent banks indicated they used various processes to provide assurance to correspondents. These are depicted in the figure below:

Figure 12: Process used to respond to queries from correspondent banks



78. Only 29 banks in 12 countries indicated that transactions had been declined by a correspondent bank due to failure to provide information on transactions. The affected countries were Angola (6 banks), South Africa (5 banks), Zimbabwe (4 banks), Kenya (3 banks), Rwanda (2 banks), Tanzania (2 banks), Zambia (2 banks), Botswana (1 bank), Ethiopia (1 bank), Seychelles (1 bank), Swaziland (1 bank) and Uganda (1 bank). This means that the large majority of institutions were able to address concerns raised by the correspondent bank.

4.4.2 *Measures taken by Regulatory Authorities*

79. The measures being undertaken by Regulators/ Authorities in response to ML/ TF risks are summarized hereunder.

Regulatory Sanctions

80. Regulatory Authorities in Angola, Botswana, Kenya, Mauritius, Namibia, South Africa, Tanzania, Uganda and Zimbabwe indicated that they had levied sanctions for AML/CFT violations to regulated institutions in their respective jurisdictions.

The Regulatory Authorities levied sanctions on the institutions for the following reasons:

Table 24: Reasons for sanctions applied by Regulatory Authorities

Jurisdiction	Reason for the sanction				
	Poor CDD	Lack of ML/TF risk assessment	Failure to report suspicious transaction	Poor record keeping	Failure to implement internal controls related to AML/CFT
Angola	-	-	-	-	Yes
Botswana	Yes	-	-	Yes	-
Kenya	Yes	Yes	Yes	-	Yes
Mauritius	Yes	Yes	-	Yes	Yes
Namibia	-	-	-	-	-
South Africa	Yes	Yes	-	Yes	Yes
Tanzania	Yes	-	-	-	Yes
Uganda	Yes	-	Yes	Yes	Yes
Zimbabwe	-	-	-	Yes	Yes

81. The types of sanctions levied on the institutions by the Regulators/ Authorities were as follows:

Table 25: Types of sanctions applied by Regulatory Authorities

Jurisdiction	Type of sanction		
	Written Warning	Fine	Suspension of license
Angola	-	Yes	-
Botswana	-	Yes	-
Kenya	-	Yes	-
Mauritius	-	-	Yes
Namibia	-	Yes	-
South Africa	-	Yes	-
Tanzania	-	Yes	-
Uganda	Yes	Yes	Yes
Zimbabwe	Yes	-	-

4.5 Preventive measures being undertaken to mitigate risks arising from de-risking

4.5.1 *Measures taken to prevent development of underground financial systems*

82. Once individuals and entities become un-bankable as a result of de-risking, there is a risk that underground financial systems may develop. Regulatory Authorities were asked to provide insights on the measures being taken to prevent the establishment of

such financial systems. One country reported that financial institutions have not yet begun de-risking their customers. Just three countries reported that they did not have measures in place to prevent the development of underground financial systems. For the countries that had taken action to prevent the development of underground financial systems, measures taken include:

(i) Training and awareness on the application of risk based approach to AML/CFT. In some countries, these trainings are conducted jointly by the FIU and the Central Bank;

(ii) Development of regulations to prevent formation of underground financial systems;

(iii) Enhanced surveillance in order to track institutions outside scope of supervision;

(iv) Engagement with law enforcement agencies to identify unlicensed entities;

(v) Development of financial inclusion policy;

(vi) Market deepening through introduction of new products;

(vii) Adoption of a risk based approach to supervision;

(viii) Conducting of National Risk Assessment to identify potential weaknesses and risk areas; and

(ix) To encourage remittances, one country (Zimbabwe) reported that remittances through the formal channels attracted some incentives to the recipient for every dollar received through formal channels.

4.5.2 *Measures taken to prevent concentration risk in smaller institutions*

83. As de-risking occurs, there is a risk that smaller institutions with less established AML/CFT programs may absorb the de-risked customers. Regulators/ Authorities were asked to provide insights on the measures being undertaken to prevent the concentration of ML/TF risks within smaller institutions with less established AML/CFT programs. Measures being undertaken by countries include:

(i) Promoting awareness on ML/TF risks;

(ii) Mandatory directives on the appointment of compliance officers;

(iii) Ensuring that all institutions are regulated and supervised including very small micro-finance institutions;

(iv) Enhanced surveillance and monitoring of high risk intermediaries;

(v) Enhanced supervision over the smaller institutions and those with weak AML/CFT frameworks;

(vi) Requiring financial institutions to conduct risks assessments;

(vii) Adoption of risk based approach with greater focus being placed on institutions with weaker AML/CFT controls;

(viii) Standardization of requirements that are applicable to all institutions regardless of size;

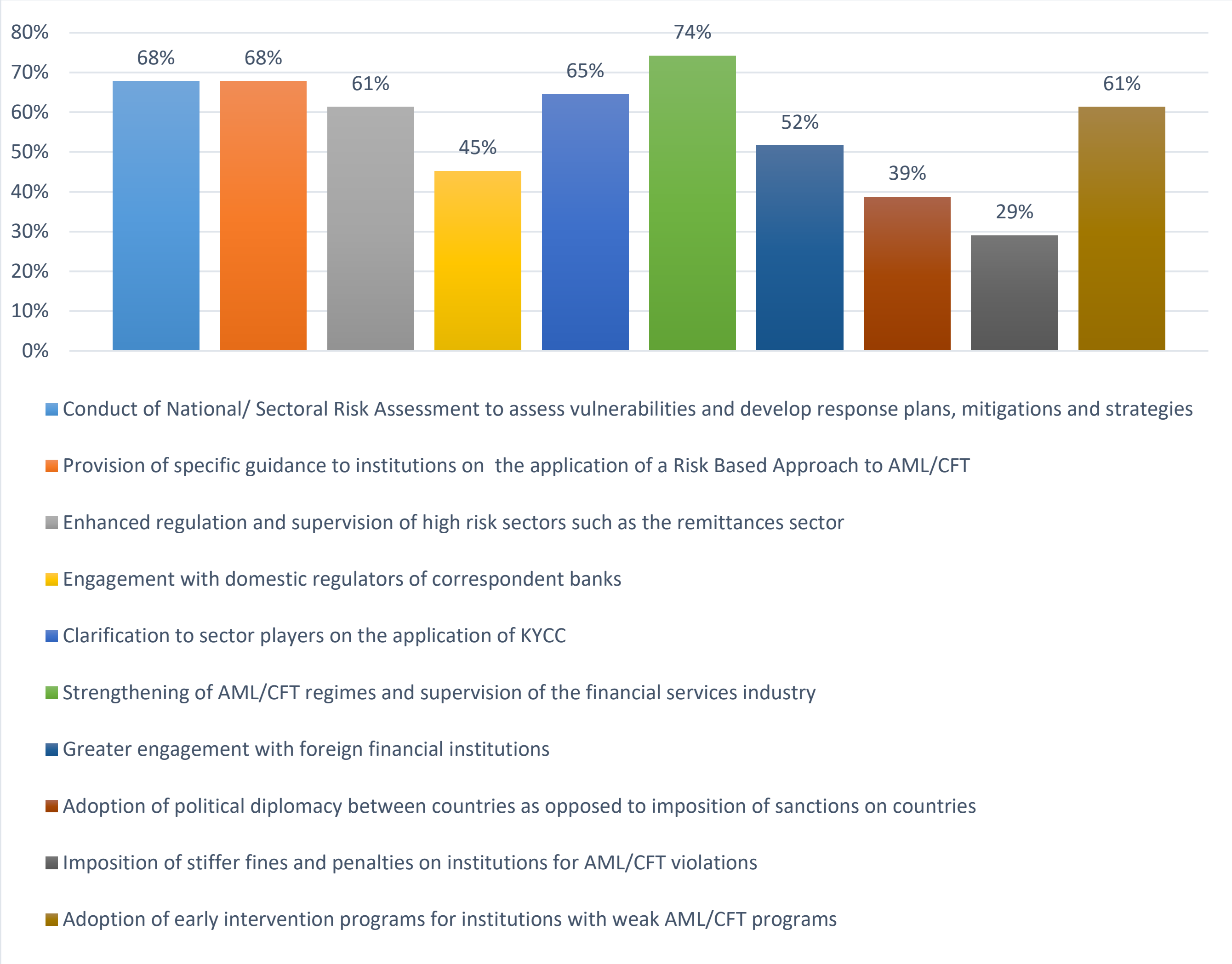
(ix) Expanding the scope of regulation to include previously unregulated entities; and

(x) Continuous training and inspections of remittances services providers (MVTS).

4.5.3 *Additional measures being taken to prevent further de-risking*

84. Regulatory Authorities were asked to provide insights on further measures that can be taken to prevent further de-risking. These are summarized in Figure 13 below:

Figure 13: Additional measures to prevent further de-risking



4.5.4 Developments in Legislation

85. Regulators/ Authorities were asked to provide insights on legislative measures that have been taken since January 2014 to address or prevent the decline in correspondent banking services provided ("P") or received ("R") by banks in their jurisdiction. These are summarized below:

Table 26: Legislative measures

Country	*Changes to regulations, other measures, or implementation*	*Entry into force*	*Brief description*	*P/R*
Angola	▪ Directives on AML/CFT to CBRS- December 2015; ▪ Directives on self-assessment regarding AML/CFT -December 2015; ▪ On-site supervision of 13 non-banking institutions	Not indicated	Not indicated	Not indicated
Kenya	Implementation of the risk-based AML/CFT supervisory regime in the banking sector	1-Jan-16	1. Development of the AML/CFT Risk Based Examination Manual 2. AML/CFT returns namely: ▪ The AML/CFT Data Control Questionnaire (quarterly) ▪ The Self-Assessment Questionnaire (submitted annually)	1. (R); 2. (P)
Malawi	Financial Crimes Act	February 2017	Expected to address shortfalls identified in 2008 mutual evaluation report	Not indicated
Rwanda	Amendment of the AML/CFT law	Not yet	The is being amended to ensure it complies with international standards	Not indicated
Tanzania	The Government of United Republic of Tanzania through Financial Intelligence Unit (FIU) has issued anti-money laundering regulations, 2012 which provide guidance on issues related to AML/CFT. The regulations cover all sectors including banks and financial institutions.	2012	The regulations interpret the Anti-Money Laundering Act, 2006 and give power to the commissioner of FIU to impose sanctions for non-compliance on issues related to AML/CFT.	R
Uganda	▪ AML regulations 2015; ▪ Anti-terrorism act 2016; ▪ Anti-terrorism regulations 2017	Not indicated	Not indicated	Not indicated

CHAPTER FIVE - KEY FINDINGS, RECOMMENDATIONS AND CONCLUSION

5.1 Introduction

86. The ESAAMLG survey on the existence, extent, causes and impact of de-risking has proven to be highly useful. The survey not only satisfied the survey objectives but has also facilitated learning amongst the ESAAMLG countries.

5.2 Key Findings

87. The survey highlighted the following key findings:

(i) Existence, nature and extent of the changing trends in de-risking within the ESAAMLG region:

- Terminations and restrictions have occurred both at the level of bank-to bank relationships (CBRs) and financial institutions-to-customer relationships;
- 40% of total respondent banks surveyed have been impacted by de-risking through termination and/or restriction of CBRs. Remittance/ wire transfer products in USD, EUR, AUD and GBP currencies were the most affected by terminations;
- 80% of financial institutions surveyed have terminated relationships with customers who were viewed as being high risk. Majority of the customers affected by terminations were customers who were from high risk countries and customers who do business with high risk countries; and
- With regard to remittance flows, de-risking had affected less than 10% of money remittance/ money value transfer service providers or their agents but had resulted in a reduction of remittances for three

countries in the ESAAMLG region. This reduction was low, affecting less than 10% of transactions.

(ii) Drivers of de-risking in countries within the ESAAMLG region:

- De-risking of CBRs was largely driven by a decrease in the overall risk appetite by correspondent banks. Other key drivers of de-risking of CBRs were lack of profitability of certain foreign CBR services/products, changes to legal, regulatory or supervisory requirements for the correspondent banks that have implications for maintaining CBRs and geographical risk particularly those subject to international sanctions; and
- De-risking of customer relationships was driven by customer due diligence concerns namely incomplete customer due diligence documentation, concerns on beneficial ownership and sources of funds/wealth. These terminations were conducted as financial institutions saw a need to conform to regulatory enforcement obligations to avoid sanctions and reputational damage and to conform to AML/CFT requirements of correspondent banks and customer due diligence. Majority of terminations have occurred in the banking sector with lower levels of terminations being reported in the other financial sectors that participated in the survey.

(iii) Assessment of the impact of de-risking in countries within the ESAAMLG region and how countries have responded to the phenomenon:

- De-risking had resulted in closure of operations, reduced scale of operations or diminished financial performance;
- With regard to de-risking of CBRs
  - → Indirect or nested correspondent banking arrangements as an alternative to direct correspondent bank relationships have emerged; and
  - → A total of 107 banks now depend on two or less than two correspondent banks for processing of more than 75% of their transactions.
- In response to de-risking phenomenon
  - → Financial institutions have adopted measures aligned to the FATF Recommendations aimed at combating ML/TF; and
  - → That Regulatory Authorities are taking measures to safeguard the financial sectors from new risks created by de-risking such as the development of underground financial systems and concentration of risks in smaller institutions with less established AML/CFT programs.

(iv) Impact of de-risking on financial inclusion efforts:

- For six jurisdictions in the ESAAMLG region, de-risking had negatively impacted access to financial products and services thereby affecting financial inclusion.

5.3 Recommendations

88. In view of the findings and conclusions drawn from the analysis, the following measures are recommended:

(i) Preventive measures to stem further de-risking:

- Countries that have not conducted national risk assessment should do so to enhance their understanding of specific ML/TF risks facing their countries and adopt commensurate mitigation strategies;
- Regulatory Authorities should strengthen the application of a risk based approach through effective capacity building for their staff and institutions and building a strong legal and supervisory framework;
- Regulatory Authorities should require institutions to conduct institutional risk assessments and apply a risk based approach to AML/CFT. Supervision in itself should be focused on assessing the existence, application, transparency and consistency of the risk identification and mitigation strategies applied by financial institutions;
- Countries should evaluate the possibility of working with regional clearing houses that offer payment and settlement systems. The clearing house would take responsibility for ensuring that all participating members have robust AML/CFT framework before being on-boarded. It will also ensure that due diligence has been conducted on participating institutions which will give a level of assurance to international correspondent banks;
- Regulatory Authorities should further strengthen the licensing and supervisory regimes applicable to financial institutions. Further, sanction regimes should be continuously improved to ensure they are deterrent; and
- Regulatory Authorities should require institutions that currently rely on manual processes to deploy technological solutions for AML/CFT surveillance, monitoring, customer due diligence and screening;

(ii) Remedial measures to address de-risking:

- Regulatory Authorities from the ESAAMLG region should collectively engage with the Regulators of correspondent banks and international policy makers with a view to developing sustainable/ amicable solutions to de-risking challenges;
- Regulatory Authorities should endeavour to build trust with correspondent banks and their Regulators by showcasing what the country is doing to ensure a robust regulatory framework is in place;
- Countries should continuously assess their situation with a view to correcting any deficiencies in the laws and regulations;
- Regulatory Authorities should issue guidelines to institutions on the minimum compliance standards for CBRs. In issuing such guidelines, the Regulatory Authorities should bear in mind the key concerns frequently raised on ML/TF risks by correspondent banks;
- Respondent banks should establish relationships with more than one correspondent bank for their primary currencies to mitigate against the effect of termination on their business operations;
- Countries should consider diversifying the currencies used in correspondent bank relationships;
- Countries should invest in and deploy appropriate technology to create a centralized database to enhance customer due diligence measures related to customer identification and beneficial ownership of legal persons and arrangements.

(iii) Ongoing situational monitoring of prevention and remediation measures:

- Countries should maintain statistics and provide updates to the ESAAMLG Secretariat on steps that have been taken to address de-risking and implementation of the recommendations of the report.

(iv) Areas for further research

- The ESAAMLG region can further research on use of block chain technology as an alternative means of supporting financial inclusion efforts.

5.4 Conclusion

89. De-risking has adversely affected the majority of countries in the ESAAMLG region resulting in closure of operations, reduced scale of operations or diminished financial performance. Only a small portion of the de-risked population has been incorporated back into the formal financial sector. De-risking has the unintended effect of excluding the majority of low income groups who are forced into the informal financial system at a time when a number of jurisdictions are preaching financial inclusion. Certainly, most people that were de-risked are now in the informal sector. In view of the negative impact of de-risking in the region, there is an increased potential of exclusion risk through ripple effects of informal activities. Therefore, there is a need to strike a balance between AML/CFT measures and financial inclusion efforts.

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