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INTERNATIONAL BANKING

Expert Analysis

International Guidance for Money Transmitters and Their Supervisors

In many countries, remittances received from abroad are essential to the recipients' welfare. But money transmission can be a high-risk business, and even though money transmitters around the world are required to comply with a detailed framework of anti-money laundering (AML) laws and regulations, they still can be misused by criminals.

However, the nature of the nonbank money transmission business does pose more risks to a country's financial system than perhaps use of a more traditional bank account. Concerned about their own potential liability should a money transmitter have regulatory problems, banks have been dropping money transmitters that have been clients for years and/or not establishing accounts for new ones. The money transmitter needs a bank account to operate, and if their access to the banking system is cut off, they are out of business and the people that may suffer in that instance include family members in other countries who need that money for their very survival.

Since 1989, the Financial Action Task Force (FATF), an international group of financial services regulators, has issued recommendations, accompanied by interpretive rules, for countries to adopt in the AML and (since 2011) the anti-terrorist financing area. Recently, the FATF issued updated guidance (Guidance) on a risk-based approach to the provision of money transmission services (referred to in the Guidance as "money or value transfer services" or MVTS).[1] This month's column will discuss the highlights of the Guidance that focus on the role that money transmitters offer to a broad range of persons who have only limited exposure to the banking system, and the concerns raised by FATF about unilateral termination of such services.

A Little Background

In developing the Guidance, the FATF focused on those recommendations[2] it considered to be most relevant to the provisions of money transmission services:

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Recommendation 1: That countries utilize a risk-based approach (RBA) in determining requirements to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified.

Recommendation 10: Financial institutions need to conduct due diligence on their customers to verify their identity.

The Financial Action Task Force has issued updated guidance on a risk-based approach to the provision of money transmission services.

Recommendation 14: Persons (individuals or entities) who provide money transmission services should be regulated and required to adopt effective systems to monitor and ensure compliance with laws and regulations against money laundering and terrorist financing.

Recommendation 16: Financial institutions should be required to obtain accurate information in connection with sending a funds transfer for a customer regarding both originator and beneficiary and have that information travel throughout the transfer chain.

Recommendation 26: Countries should enact laws and regulations to implement the FATF Recommendations for all financial institutions subject to those Recommendations.

A Risk-Based Approach

The risk-based approach is used in other areas of financial services regulation and for FATF, MVTS is no different. The task force believes that the risk-based approach is critical to effective implementation of the recommendations by all affected financial institutions. Money transmission services are offered by a variety of providers, such as banking institutions, large nonbank money transmission companies, and small businesses providing money transmission services as agents of large nonbank money transmitters.

Each type of business carries a different risk profile and it is incumbent for money transmitters, and their regulators, to be able to accurately identify the risks to which they are exposed and enact and implement the measures that need to be in place to counter those risks.

Money Transmitters

The majority of the guidance is directed to money transmitters regarding developing an accurate risk assessment tailored to the particular business operation, and ensuring that appropriate internal controls and a compliance infrastructure are in place and in line with that risk assessment. In addition, emphasis is placed on robust customer due diligence procedures and effective vetting and oversight of those acting as agents of money transmitters.

Regulators

Regulators also are advised on developing their own risk-based approach to supervision of money transmitters, including by developing an understanding of their business operations, services and products, and usual customer base in order to make a more accurate risk assessment. Training of the supervisory staff also is necessary to ensure a level of expertise of the money transmission process when conducting examinations of the money transmitters.

Supervisors should have off-site and on-site access to relevant risk and compliance information, and if necessary, should adjust periodic examination cycles or targeted examinations as necessary to continue to maintain accurate risk assessments of the money transmitters under their jurisdiction.

Much of this guidance is relevant to any regulated financial institution. Effective communication flows between regulators and the business are necessary in order to ensure an accuracy of expectations on both sides. Moreover, regulators have the necessary enforcement authority when necessary to address illegal activities or defective controls or compliance at a particular money transmitter. The Guidance also provides examples of different countries' supervisory practices in this area.

Importance of Services

Not everyone has a bank account or even access to traditional banking services and needs to use money transmitters to send money to family, to pay bills, and to take care of everyday financial needs. In the Guidance, the FATF notes that money transmitters play an important role in providing access to a broader range of financial services to disadvantaged persons with few current alternatives.

The Guidance notes that while sending of remittances is an important service, there can be significant risks and thus remittances should be offered only by properly regulated providers. However, the FATF flatly states that "an indiscriminate termination or restriction of business relationships to [money transmission service] providers without proper risk assessment and mitigation measures could potentially increase the level of financial exclusion, diverting the customers towards services and channels bearing an increased level of risk." The FATF goes on to state:

> The FATF does not support the wholesale termination or restriction of business relationships to MVTS providers (or other sectors) to avoid, rather than manage, risk in line with the FATF's risk-based approach. Rather, financial institutions should take into account the level of [money laundering/terrorist financing] risk of each individual MVTS provider customer and any applicable risk mitigation measures whether these are implemented by the financial institution or the MVTS provider customer. Usually the [risk-based approach to supervision] presumes that the risk associated with any type of customer group is not static and the expectation is that within a customer group, based on a variety of factors, individual customers could also be classified into risk categories, such as low, medium or high risk, as appropriate. Measures to mitigate risk should be applied accordingly.

As noted above, most money transmitters must have access to a bank account in order to engage in the money transmission business. As a result, if a bank terminates an account for a money transmitter, even if there has never been a problem, money laundering or otherwise, and the money transmitter cannot find a replacement bank, the money transmitter will not be able to operate. As a result, this could lead to a loss of jobs in a particular community, and fewer choices for customers who need to have access to a money transmitter to send money to their families or address their own financial needs.

Guidance for Banks

The FATF quite rightly notes that money transmitters are subject to the full menu of anti-money laundering compliance requirements, including "know your customer" due diligence, cash reporting requirements, detailed recordkeeping and reporting of suspicious transactions. For banks considering offering banking services to a money transmitter, the FATF offers specific factors to consider including the following:

• A risk-based approach should be followed in banking money transmitters, and as noted above, a bank, understanding the necessity of a money transmitter being able to access a bank account, should not resort to the "wholesale termination or exclusion of customer relationships" of money transmitters without "a proper risk assessment."

• When banks are reviewing a potential customer who is a money transmitter, the bank should evaluate the anti-money laundering/terrorist financing risk and weigh different risk factors including products and services to be offered, types of customers and jurisdictions to which funds should be transmitted, and determine how the bank will manage and mitigate any such risks.

> Each type of business carries a different risk profile and it is incumbent for money transmitters, and their regulators, to be able to accurately identify the risks to which they are exposed and enact and implement the measures that need to be in place to counter those risks.

• Proper due diligence is necessary when opening an account for a money transmitter, as it would be for any new customer. Due diligence should include reviewing information on the customer and its ownership structure, focusing on the possible risks involved with banking that particular proposed customer.

• A bank should provide for effective and risk-based ongoing monitoring of all its accounts for potential suspicious transactions, including accounts for money transmitters.

There may be many different reasons why a bank would refuse a potential money transmitter a bank account or terminate the account of a current one. Regulators should understand the reasons why such decisions are made and emphasize to the banks under their jurisdiction the necessity of taking a risk-based approach to a particular customer and not the entire money transmission industry. After all, terminating legitimate money transmitter banking relationships may end up forcing customers into doing business with unregulated money transmitters, thus depriving customers of access to consumer rights that come from dealing with a regulated entity, and regulators of the ability to monitor funds flowing through nonbank money transmitters.

This section of the Guidance ends with a reminder to regulators to provide guidance to banks on providing services to money transmitters, emphasizing the need to apply a risk-based approach to each customer and that risks will vary from customer to customer, and advising on the various risk-mitigating tools that are available to banks when providing these services.

Regulators also should provide clear information on what they expect of the banks and consider offering examples of internal controls and procedures that the money transmitter could put in place to manage its risks. The Guidance includes annexes providing examples of what is done by both the private sector and the regulators in different countries in utilizing a risk-based approach to banking money transmitters.

Conclusion

At times, it may be difficult to reconcile regulators' expressed concerns about access to financial services (such as money transmitters) by those who cannot afford or have access to bank accounts, with their equal emphasis on robust compliance with AML laws and regulations. As the FATF notes in the Guidance, regulators must realize that all the regulation and diligence in the world still may result in a problem at a money transmitter, but if there are effective internal controls, such a problem can be caught early and rectified. It is not necessary to eradicate an entire industry because there have been problems.

The Guidance speaks to a more even-handed approach to regulation and supervision, effective internal controls and compliance at all financial institutions, and a recognition of the usefulness of certain nonbank services. It is heartening to see that the FATF, in a document discussing the necessity for robust regulation of money transmitters, also emphasizes that unilateral termination of banking services for these businesses is not the long-term answer to the AML problems. Moreover, the FATF flatly states that "the wholesale cutting loose of entire classes of customer, without taking into account, seriously and comprehensively, their level of risks or risk mitigation measures for individual customers within a particular sector, cannot be considered as being in line with FATF standards."

1. Financial Action Task Force: "Guidance For a Risk-Based Approach: Money or Value Transfer Services," February 2016, which can be accessed at http://www.fatf-gafi.org.

2. The Recommendations can be accessed at http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf.