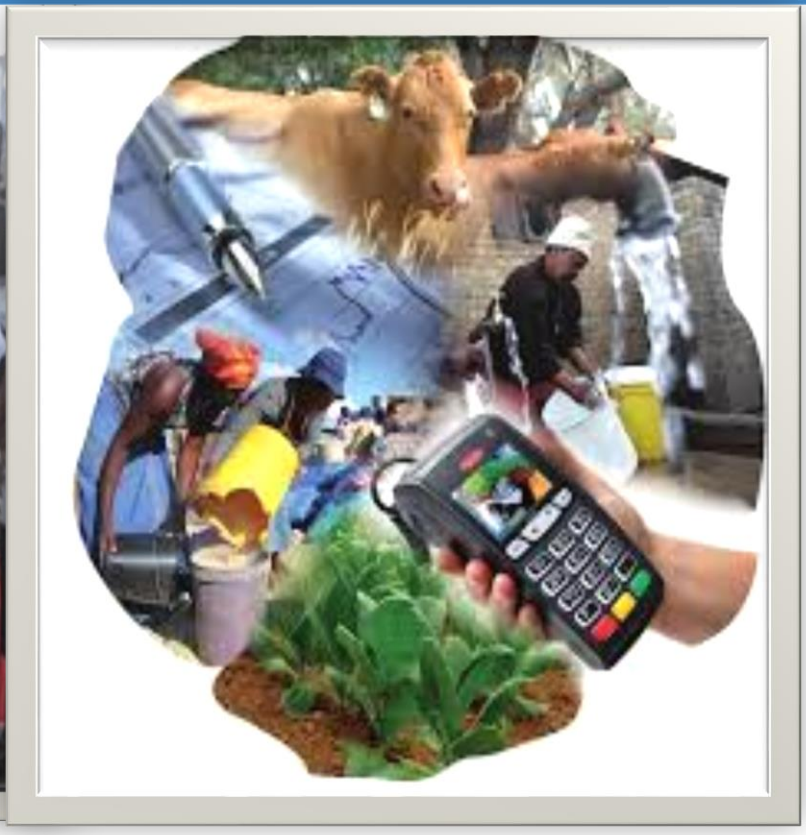
Know Your Customer/ Customer Due Diligence Measures and Financial Inclusion in West Africa

An Assessment Report

June 2018





The Inter-Governmental Action Group against Money Laundering (GIABA) is a specialized institution of ECOWAS and a FATF Style Regional Body that promotes policies to protect member States financial system against money laundering, terrorist financing and the financing of the proliferation of weapons of mass destruction. The FATF Recommendations are recognised as the global anti-money laundering (AML) and counter terrorist financing (CTF) standard.

For more information about GIABA, please visit the website: www.giaba.org

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GIABA Secretariat

Executive Summary

1. This report is the outcome of a study conducted directly by the Inter-Governmental Action Group against Money Laundering in West Africa (GIABA), which commenced in September 2016. The study is a follow up to an earlier study on financial inclusion carried out in 2013. It was undertaken to understand and address the challenges of implementing the money laundering and terrorist financing (ML/TF) preventive measures of Know–Your-Customer (KYC)/Customer Due Diligence (CDD) with due regard to financial inclusion. On the basis of the findings of the study, recommendations have been made to assist the relevant authorities in GIABA member States to design effective KYC/CDD frameworks that promote financial inclusion, in compliance with the letter and spirit of the Financial Action Task Force (FATF) Recommendations and Assessment Methodology (as revised).

2. The report will considerably help countries in the region as they struggle to expand access to financial services for the people, while ensuring effective protection of their financial systems against ML/TF. In so doing, countries in the region will be able to adapt the flexibility offered by the risk-based approach (RBA) to the implementation of ML/TF preventive measures, as contained in the international anti-money laundering and countering the financing of terrorism (AML/CFT) standards.

3. The study which was conducted under the overall supervision of the GIABA Director of Research and Planning, covered all the 15 ECOWAS countries and involved fieldwork by staff of the Directorate in some of the sampled countries. Relevant data were collected from financial institutions and competent authorities (regulators and supervisors) using questionnaires, individual interviews and focus group discussions.

Key findings

4. West Africa's financial sector has been growing steadily over the last 5 years, indicating positive results from the financial inclusion policy drives of countries over the period. The growth has been in financial products such as rural banking, micro-finance, remittances, foreign exchange bureau, and electronic finance, which are targeting agriculture, SMEs and market women. However, the expansion has been moderate, and this moderate growth betrays sub-optimal progress on financial inclusion.

5. In spite of this growth, financial access remains highly skewed in the region, representing between 10% and 30% of the population. Access is skewed in favour of those with formal education, formal employment, and those living in cities or urban townships.

6. A major reason, amongst others, for this subdued financial sector growth is that the implementation of AML/CFT measures, in general, and KYC/CDD in particular, is rigid in many countries. The legal and regulatory frameworks governing the conduct of KYC-CDD requirements lack the flexibility to allow financial service providers to implement the RBA in an effective manner.

7. Lead industry players, particularly in the banking sub-sector, tend to have strong compliance frameworks, which incidentally limit financial access. However, smaller players that may facilitate financial inclusion tend to have weak or non-existent compliance frameworks. Instructively, most countries in the region have not undertaken sectoral or national AML/CFT risk assessment. The lack of such assessment and the lack of national guidance frameworks hamper the adoption of the RBA by financial institutions in relation to their KYC-CDD obligations.

8. In most countries, KYC-CDD guidelines exist for operators, particularly in the emerging sectors of micro-finance, mobile money and foreign exchange. However, such guidelines are not explicit on the different types of customers or products and, thus, do not allow for flexibility.

9. Customer identification and verification remain the major obstacles to the flexible CDD implementation by operators, which inhibit expansion of financial access. With a few exceptions, financial institutions still rely on the traditional methods (old fashion, including the tick-the-box approach) to customer identification and verification. The traditional method is not based on risk assessment, and does not profile the customers or specific products. Hopefully, the few countries that have completed their national ML/TF risk assessments would be designing a RBA framework to customer identification/verification.

10. Generally, Regulation and Supervision of CDD implementation by financial service providers are weak across the region. Financial service providers – particularly micro-finance, insurance, foreign exchange bureaus and mobile money businesses providing technology-driven financial services (fintech), all of which hold huge promise for financial inclusion – are not receiving sufficient or effective monitoring, control or guidance from supervisory and regulatory authorities. On the one hand, emerging service providers with the potential of expanding financial inclusion are the least supervised and do not know their AML/CFT obligations, let alone complying with any KYC-CDD guidelines. On the other hand, many traditional financial institutions, such as banks, are more supervised but do not receive appreciable feedback from regulators and supervisors on reports (STRs and other reports emerging from the application of KYC-CDD measures) they file.

11. A key factor for this weak supervision is the low level of knowledge on financial technology among supervisors and regulators. In terms of expertise, some of the operators are far ahead of their regulators and supervisors, who do not go beyond the traditional onsite/offsite inspection and ML/TF risks assessment on technologically driven financial products and services. Another factor is a sub-optimal collaboration between supervisors/regulators and operators in the emerging growth sectors with high potentials of reaching the underserved.

12. In order to enhance financial inclusion in the implementation of KYC-CDD measures, some recommendations have been made. A key recommendation is for countries to create a consolidated customer database for the purpose of identification and verification, which should be made accessible to all operators. Such database may include biometric information with unique identification numbers such as the Bank Verification Number system rolled out in Nigeria.

Glossary of Terms

AML	Anti-Money Laundering
ATM	Automated Teller Machine
BCBs	Basel Committee on Banking Supervision
BCEAO	Central Bank of West African States
BVN	Biometric Verification Number
C	Compliant
CBN	Central Bank of Nigeria
CDD	Customer Due Diligence
CFT	Counter Financing of Terrorism
CGAP	Consultative Group to Assist the Poverty
ECOWAS	Economic Community of West African States
FATF	Financial Action Task Force
Fintech	Financial technology
FIU	Financial Intelligent Unit
FSAP	Financial Sector Assessment Programme
FSRB	FATF Style Regional Bodies
G20	Group of Twenty (forum of finance ministers and bank governors of developed nations)
GIABA	Inter-Governmental Action Group against Money Laundering in West Africa
HE	High level of Effectiveness
ID	Identity Document
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
IO	Immediate Outcome
KYC	Know Your Customer
LC	Largely Compliant
LE	Low level of Effectiveness
ME	Moderate level of Effectiveness
ML	Money Laundering
MVTS	Money and Value Transfer Services
NA	Not Applicable
NC	GIABA National Correspondent
NC	Non-Compliant
NGO	Non-Governmental Organisation
NRA	National Risk Assessment
OFC	Offshore Financial Centre
PC	Partially Compliant
PoS	Point of Sale
R	Recommendation
RBA	Risk Based Approach
Regtech	Regulatory technology
SE	Substantial level of Effectiveness
SSB	Standard Setting Bodies
STR	Suspicious Transaction Report
Telco	Telecommunication Company

TF	Terrorist Financing
UN	United Nations
WAEMU	West Africa Economic and Monetary Union

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SECTION 1

Introduction

Background

1. Money laundering (ML) and terrorist financing (TF) pose significant threats to human development especially in the areas of economy and security. West African countries are particularly more vulnerable to the threats due to the inherent weaknesses of institutions and systems. The phenomena of ML and TF are also not abating. Over the years, the threats have become more pronounced, notwithstanding substantial Anti-Money Laundering (AML) and Counter Financing of Terrorism (CFT) efforts by national governments, regional organizations, and development partners. Both phenomena are becoming more complex and dynamic, as evidenced by the use of innovative and sophisticated methods and techniques by criminals, terrorists, and their collaborators. The dynamic nature of the two phenomena is underpinned by rapid globalization and technological advances that have made financial services increasingly ubiquitous, private and personal more than ever before.

2. However, in spite of the growing threat of these crimes, counter-measures have been far less commensurate in West Africa. A major factor for such inadequacy is the prevalence of financial sector vulnerabilities, such as inadequate payment system infrastructure, weak frameworks for implementing Know-Your-Customer (KYC)/Customer Due Diligence (CDD)[1] measures, poor record keeping, high transaction costs, the slow pace of transaction, human resource paucity and poor work ethics, lack of service provider transparency, lack of confidence in financial institutions, limited access to financial services due to location or lack of means and the lack of basic financial literacy, among others. Evidence from published mutual evaluation reports of GIABA member States shows that CDD frameworks are poor, hence most of the countries are non-compliant on the Financial Action Task Force (FATF) recommendation on customer due diligence.[2] This deficiency has been identified as a central factor for excluding at least 2.5 billion of the world population from banking services (CGAP, 2010).

3. Financial authorities around the world are increasingly recognizing the importance of ensuring that financial institutions have adequate controls and procedures in place so that they know the customers they are dealing with. Adequate due diligence on new and existing customers, therefore, is a key part of these controls. Without this due diligence, banks can be exposed to reputational, operational, legal and concentration risks, which have huge financial and liability consequences.

4. In 1999, the Basel Committee, in a cross-border banking survey, identified deficiencies in a large number of countries' know-your-customer (KYC) policies for banks. Judged from a supervisory perspective, the survey shows that KYC policies in some countries have significant

[1] KYC (Know-Your-Customer) is the industry term for CDD (Customer Due Diligence), which is a compliance term.
[2] http://www.giaba.org/media/f/769_ENG%20-Strategic%20Review%20of%20GIABA%20First%20Round%20of%20Mutual%20Evaluations%202007-2012%20-trackled%20changes.pdf

gaps and in others they are non-existent.[3] Even among countries with well-developed financial markets, the extent of KYC robustness varies.

5. KYC is most closely associated with the fight against ML/TF, a role largely under the purview of the FATF as the foremost global standard setting body. Mindful of the FATF efforts, the Basel Committee's interest is on a wider prudential perspective. KYC safeguards go beyond simple account opening and record-keeping, and require banks to formulate a customer acceptance policy and a tiered customer identification program that involves more extensive due diligence for higher risk accounts. It also includes proactive account monitoring for suspicious activities. Sound KYC policies and procedures are, therefore, critical in protecting the safety and soundness of banks and the integrity of the banking systems.

The Research Problem

6. The assessments done by Standard Setting Bodies (SSBs) of the global financial sector, such as the Financial Action Task Force (FATF) and the Basel Committee on Banking Supervision (BCBS), showed that the CDD framework of most countries are either weak or suffers from poor implementation of internal AML/CFT controls (including KYC/CDD), particularly in the developing world. The weak implementation could be mainly due to a lack of effective financial supervision framework based on solid principles of regulatory effectiveness i.e., lack of objectivity in general supervision and inspections results in arbitrary & selective enforcement of rules; and lack of use of monetary penalties for addressing compliance in general financial supervision as well as AML/CFT supervision.

7. For AML/CFT systems to be effective and impinging upon financial inclusion, it is important that supervisors have a solid understanding of what a "rules based" (the tick-the-box) approach is and how it is implemented (based on principles of regulatory effectiveness), because the RBA is a much more advanced system than a rules-based approach. Without sufficient understanding of a rules-based approach, the RBA will merely exacerbate the arbitrary & selective enforcement aspects of a poor supervision system which easily corrupts it. Yet, major financial institutions around the world have alleged that the CDD framework is the principal factor preventing them from achieving their financial inclusion objectives.

8. The paradox embodied in that allegation and the importance of a regulatory framework for global financial stability is evident. More so, as the world continues on the path to recovery from the 2008 financial crisis that had threatened global stability, peace and security, global leaders and multinational organizations need to act together in addressing ML and TF risks, particularly the vulnerabilities manifested in the governance frameworks of the financial sector globally.

9. De-risking is another emerging issue where this paradox manifests. De-risking is a situation where financial institutions terminate or restrict business relationships with entire countries or classes of customers to avoid, rather than manage, risks in line with the FATF's RBA. This phenomena is evident in the West African region, where banks complain of the severance of relationships with their correspondent banks overseas due to risk aversion. This has the potential to put the region's indigenous banks out of business thus making them less competitive. De-risking

[3] http://www.bis.org/publ/bcbs85.pdf

remains a serious concern globally, including in the West African region, to the extent de-risking may drive financial transactions into less/non-regulated channels, reducing transparency of financial flows and creating financial exclusion, thereby increasing exposure to ML/TF risks.

10. In view of the complexities related to providing good financial sector governance, effective control and management of customer risks and considering the need to promote financial inclusion, the G20 and the UN have called on the SSBs and other development partners to look into the existing challenges, mindful of the mutually reinforcing objectives of financial inclusion and effective regulatory framework (both prudential and AML/CFT). This is believed to not only have the potential to extend financial services to the 2.5 billion unbanked population, but also to create a larger financial market for service providers to tap into and widen the scope of supervision and regulation, resulting to improve consumer protection and combating of financial crimes.

11. In response to the G20 call, the FATF and other FSRBs, including GIABA, have conducted studies on the nexus between financial inclusion and AML/CFT. In addition, GIABA has contributed to the existing literature on the mutually reinforcing objectives of AML/CFT and financial inclusion. Furthermore, the FATF has revised both its Standards in 2012 and the assessment methodology in 2013. It also developed a guidance on the RBA and a special guidance on financial inclusion and new payment methods to promote financial inclusion in order to make AML/CFT more effective. GIABA sponsored two studies on financial inclusion and AML/CFT. The findings of these studies underscored the fact that the KYC-CDD frameworks in GIABA member States are weak and the regulatory as well as supervisory processes lack the ability to adopt a robust RBA framework. These findings justified the need to conduct a more focused assessment on the existing KYC-CDD framework, focusing on the effects on providing financial services to, not only the traditional formal sector, but the large informal financial sector that is vulnerable to abuse by criminals for the purposes of ML and TF.

Research Questions

12. In order to fully understand the complexities of the existing KYC-CDD processes and procedures, and to highlight the challenges that need to be addressed in order to reach out to the financially underserved, who mostly rely on the informal sector for financial services, the following question were raised:

i. What are the legislative and legal arrangement that member States have in place with regards to KYC-CDD?
ii. Are the existing regulatory and supervisory frameworks, guidance documents, and compliance manuals developed for service providers adequate?
iii. What is the level of flexibility in the application of the existing processes and procedures, particularly when new approaches are introduced as good practices that have the ability to improve the framework?
iv. What is the capacity of the financial sector players to perform their functions more effectively and efficiently in a rapidly changing and evolving world?
v. What are the infrastructural and policy challenges that need to be addressed? and
vi. What are the implications for the overall regulatory and supervisory environment, particularly for AML/CFT?

Methodology

13. The research was conducted by staff of the Research and Planning Directorate of GIABA Secretariat and involved three phases. Phase one involved desk review of literature and other secondary information, while phase two involved field visits where questionnaires were administered and interviews were conducted, and supporting documents collected, and phase three involved putting the report together. Substantial amount of quantitative and qualitative information were gathered and analysed as presented in this report. In some case, questionnaires, were administered ex-ante, followed by on-site interviews, both with individuals and groups (Focus Group Discussions). The Director of Research and Planning provided quality control, including ensuring that activities are carried out in full compliance with the study work plan.

14. In terms of scope, the survey covered all the eight (8) central banks in West Africa (BCEAO, Central Bank of Cabo Verde, the Gambia, Ghana, Guinea, Liberia, Nigeria and Sierra Leone), and Cote d'Ivoire and Togo (due to the size and level of financial sectors of the two countries). Headquarters of regional banks and other financial institutions were visited as well. Questionnaires were also sent and responses received from the member States that were not visited (Benin, Burkina Faso, Guinea Bissau, Mali and Niger). In effect, all the15 ECOWAS member States were involved in the study. The study lasted for twenty (20) months, from September 2016 to April, 2018.

15. Some of the limitations of the study include data quality and incompleteness. In some of the responses provided, it was difficult to come to a conclusion on what the data represents – progress or otherwise. As in most of the studies conducted in the region, keeping to schedule is often difficult. However, the time factor was mitigated through extensions granted to the project team.

SECTION 2

KYC-CDD Implementation in relation to Financial Inclusion:

A Review of Literature

16. The FATF Recommendations cover a number of subjects that impact on financial inclusion. As identified in the revised FATF Guidance on financial inclusion (2013), four topics in the Recommendations stand out – customer due diligence (CDD) practices, record keeping and monitoring, remittances and other money transfer services, and issues relating to agents with responsibility for AML/CFT compliance. Of these topics, CDD is the most fundamental when it comes to financial inclusion as it cuts across all other topics, and, also, because it serves as the first line of prevention against the commission of ML/TF crimes. Notably, the main controversies surrounding the impact of AML/CFT measures on financial inclusion mostly hover around the implementation of CDD requirements. For example, in order to ensure compliance with CDD requirements, countries have traditionally tended to include in their AML/CFT regimes rigid 'know your customer (KYC)' requirements of identification and verification that could not be met by poor households and migrant communities.

17. There are about 12 main requirements for KYC-CDD as listed below:

a. Identification of customer - Origin, residence, workplace, meeting the banking age or qualifying for a product, criminal background checks, etc.).

b. Review of business type – Identify the legality, know the main sources of funds, etc.

c. Beneficial ownership – Establish the true ownership and control of funds especially if relationship is to be established.

d. Risk profiling – In relation to a one time or infrequent transaction that meet the thresh hold; in relation to the type of relationship to be established; while acquiring a particular product in relation to its inherent risks; risk to reputation; possibility of conflict of interest, etc.

e. Categorisation – To place the client on simplified, normal or enhanced CDD.

f. Ongoing customer/client monitoring programme – Taking due consideration of the risk profile and relationship type.

g. Employee screening and continuous monitoring.

h. Employee training and retraining.

i. Data retention and supporting investigation.

j. Reporting STRs/CTRs, as necessary.

k. Establishment of the compliance function at managerial level to oversee institutional compliance with CDD and other AML/CFT measures; and

l. Establishment of a framework for the continuous monitoring of risks and applying RBA in all customer related operations.

18. The initial emphasis of the CDD requirement, therefore, appeared to have brought international AML/CFT community into head-on collision with the international development agenda. The AML/CFT community appeared to have viewed the informal financial world as a haven of unregistered players, unrecorded transactions and untraceable money trail, all of which were not amenable to regulation and, thus, pose serious threats to financial integrity. The conclusion, for this school of thought, seemed to be that financial inclusion allows for the free mingling of 'safe' and 'unsafe' operations in ways that hurt financial integrity and stability.

19. On the other hand, the development community charged that unmitigated expansion of financial sector regulation, particularly the maximalist application of the international AML/CFT standards in developing countries or among marginal communities (refugees, asylum seekers, immigrants, etc.) in advanced countries would push the poor and the weak further away from accessing financial services (World Bank 2014). The furtherance of financial exclusion, as held, would exacerbate poverty and undermine the possibility of lifting the masses of the socially disempowered. For this school of thought, an insensitive, rigid preoccupation of regulators with financial integrity and stability hurts financial inclusion, undermines social policy and ossifies poverty. Consequently, international development organisations – chiefly the World Bank – kept their work of financial inclusion and financial integrity apart, or, at best, pursued the former from the perspective of social policy to the neglect of the latter.

20. As aptly captured by the World Bank (2014, xiii), while the FATF Recommendations appeared to be straightforward, regulating and supervising financial institutions, in practice, it has been an arduous task across the globe, particularly in relation to money transfer businesses. This challenge was fuelled by the tragic events of September 11, which exposed the high risk of terrorist financing (TF) through international remittance channels. As a response to those events, the FATF Standards were expanded from the initial 40 Recommendations on AML to 40+9 Recommendations in 2001, with the additional 9 Special Recommendations focusing on TF. That revision, for the first time, brought remittance service providers under strict government oversight with terms that considerably excluded a wide range of clients from accessing such services, thereby exacerbating financial exclusion. Thus the international community was faced with a dilemma - on the one hand, concerns about the real risks of ML and TF occurring though financial services meant to strengthen inclusion and on the other hand, AML/CFT requirements meant to protect the system from criminal abuse but which imposed considerable restrictions on financial service providers leading to the exclusion of more people from accessing such services.

21. However, this situation began to change from 2010 as a result of amassing body of evidence of the negative impact of the misapplication of the FATF recommendations impacting on financial inclusion. The international SSBs themselves began to question the effectiveness of the overly rigid and technical approach to AML/CFT standards they have set. As observed by Isern & de Koker (2009), the fear of the political economic consequences of a negative mutual evaluation report forced some FATF members into the "over-compliance" mode, thereby driving many financial service providers and/or their clients into the informal sector. More particularly, as the risks of serious financial crimes associated with financial exclusion became increasingly undeniable, the stimulus for financial inclusion shifted beyond the grounds of social policy (the

development agenda of bridging social inequality and reducing poverty). The new, if not the preponderant, impetus for financial inclusion therefore became how to ensure the effectiveness of the international AML/CFT standards and their implementation by bringing the totality of financial transactions, including the transactions of those excluded from or under-served by the regulated formal financial sector into the orbit of regulation (FATF 2013: 7). Consequently, the contradiction between international financial regulation and international development on the question of financial inclusion appears to be resolved by the growing concern with the effective implementation of AML/CFT measures and the resultant revision of the international AML/CFT architecture in 2012 and 2013.

22. At the international level, a system of finance has emerged with very clear structures and a global management system lead by the International Monetary Fund. The international financial system is under constant threat from different forces both legal and illegal. To protect the system, many surveillance and protection systems and mechanisms have been integrated into it. The FATF constitute one of such mechanisms. The primary function of the FATF is to protect the global financial system from the proceeds of crime, and does this through the global AML/CFT network, constituting of countries and organisations. GIABA, is a member of that network.

23. The desire by financial institutions to protect their businesses from exposure to risks arising from their customers and the desire of the FATF and other relevant stakeholders to protect the integrity of the international financial system provide a meeting point for Customer Due Diligence and knowing customers and the businesses they are engaged in. Perhaps, this meeting point also serves as a departing point for the two blocks.

24. The implementation of Customer Due Diligence (CDD) requirements by financial institutions, as part of measures to strengthen the integrity of the global financial system, has been fraught with contradictions from the start. At the emergence of the current global architecture for protecting the integrity and stability of the world's financial system from criminal abuses, such as money laundering (ML) and terrorist financing (TF), questions relating to the possible exclusion of a sizeable percentage of the population from benefitting from mainstream financial services or with regard to those with limited access to such services were largely ignored as non-essential.[4] The unspoken conventional wisdom held by global standard setting bodies (SSBs)[5] was that the abuse of the world's financial system occurred only in the formal financial sector and that once that sector was optimally regulated, the goal of financial integrity would largely have been attained. Another sympathetic argument to this blind spot is that at the time when ML became of international concern, it was largely seen from a limited horizon – drugs, organized crime and corruption.

25. This thinking shaped the focus of a raft of global (multilateral, international, regional and national) AML/CFT institutional frameworks, policies and standards that developed rapidly from the eve of the Millennium. Most prominent among these global initiatives include the adoption of a number of United Nations instruments - the Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 1988; the Convention against Trans-national organize Crime, 2000;

[4] The category of people financially excluded includes low income, rural sectors and undocumented groups, in both developing and advanced countries.

[5] The global standard setting bodies on anti-money laundering (AML) and combating of the financing of terrorism (CFT) include the FATF, the World Bank, the IMF and the Basel Committee.

International Convention for the Suppression of the Financing of Terrorism, 1999; The Convention against Corruption, 2003, among others; the establishment of the Financial Action Task Force (FATF) in 1989 and the evolution of its Recommendations on anti-money laundering (AML) and combating the financing of terrorism (CFT), and the subsequent establishment of FATF Style Regional Bodies (FSRBs) in the various regions of the world; the birth of the joint Financial Sector Assessment Programme (FSAP) of the International Monetary Fund (IMF) and the World Bank in 1999; the establishment of the IMF Offshore Financial Centre (OFC) Assessment Programme in 2000; the establishment of the AML/CFT Assessments and the AML/CFT Technical Assistance programmes of the IMF, both in 2004.

26. Of all these developments, the FATF Recommendations is the most embracing and constitutes the bedrock of the global AML/CFT Standards and forms the basis for regulating the global financial system from criminal abuse.

27. The 2012 declaration by FATF Ministers that financial exclusion represents a real risk to achieving effective implementation of the FATF Recommendations, therefore, marked a public acknowledgement of a defect in the AML/CFT architecture identified two years earlier, which culminated in the publishing of the initial FATF Guidance paper on financial inclusion a year earlier (2011). The declaration was also significant because it was made at the occasion of the renewal/approval of FATF's mandate (2012-2020) and, thus, officially signalled immediate 'shift' in its work, as evidenced in the flurry of revisions of its key documents through 2012 and 2013.

28. The revision of the FATF Recommendations was, admittedly, a watershed mirrored by the introduction of two core requirements, among others –risk assessment (RA) and the RBA to the implementation of AML/CFT measures. Based on the outcome of the RA, the RBA is meant to serve as the tool for ensuring that regulation is tailored to risks that are assessed taking into consideration peculiar specific national contexts without compromising the effectiveness of the AML/CFT regime. The new measures, as argued by the Basel Committee (2014: 7), provide the flexibility that enables country-level policy makers to craft CDD requirements that do not inadvertently exclude the poor (and under-served) who are not able to meet or satisfy customer identification and verification criteria. The revision of the Guidance paper on financial inclusion, therefore, was mainly to explain the flexibility provided in the revised FATF Standards enabling countries to fashion effective and appropriate AML/CFT regulations and measures fully in line with the Recommendations (FATF 2103: 5). The Guidance, thus, promises to harmonise the two objectives of financial integrity and financial inclusion in practice.

29. Finally, the introduction of a new assessment component meant to evaluate the effectiveness of countries' AML/CFT regime, provides a basis for holding countries to account for practices that promote financial inclusion or exclusion. By emphasising the extent to which a country's regime actually accomplishes its objective of preventing or containing ML/TF, the requirement to prove the effectiveness of the AML/CFT system on the basis of the RBA compels countries to ensure that CDD implementation across all the spectrum of financial transactions do not negatively impact on financial inclusion. It also puts pressure on countries to find ways and means of extending AML/CFT measures in the informal financial services channels such that the AML/CFT systems must be effectively implemented in ways that do not impinge on financial inclusion objectives. The requirement for countries to demonstrate the effectiveness of their AML/CFT systems implies that money laundering and terrorist financing through the informal

financial services channels is an acknowledgement that technical compliance alone is not sufficient to make AML/CFT regimes effective. Financial inclusion is, thus, increasingly being viewed from the point of view of reducing ML/TF total risks, by encouraging more people to use the regulated formal financial system.

30. The FATF actions discussed above, taken together, could be seen to represent a marked shift towards the end state of crafting and implementing CDD measures in such a way that encourages financial inclusion and effective AML/CFT compliance. This much desired shift was succinctly captured by the UN Secretary-General's Special Advocate for Inclusive Finance for Development (H.M. Queen Máxima of the Netherlands) in 2013. She noted that '… we have come from a situation where financial integrity was seen as a barrier to financial inclusion to the situation today where there is a general recognition that financial inclusion, financial integrity and financial stability are not only compatible, but also mutually reinforcing.'

31. Yet, in spite of the bold steps taken and determined efforts by the FATF, the implementation of CDD measures at the country-level consistent with the new emphasis on effectiveness through the promotion of financial inclusion will require sometime to prove itself. Already, reports from the new round of mutual evaluations which employed the new standards has had, at best, a problematic start across the globe. In many countries, both developing and advanced, financial service providers have not been able to take advantage of the flexibility provided by the RBA. Understanding and applying the RBA in a proportionate and calculated way have not been straightforward for many of the institutions. This has led to less than satisfactory performance on CDD implementation that promotes financial inclusion, or at least, does not promote exclusion, even in advanced countries. A compilation of the outcomes of recently concluded Fourth Round Mutual Evaluations of countries across the globe against the 2012 (revised) FATF Recommendations, using the 2013 (revised) FATF Methodology, shows that national-level effective implementation of CDD measures in the context of expanding financial inclusion remains a global challenge. The compilation is represented in the two (2) tables below, as adapted from the *Consolidated Table of Assessment Ratings*, published by the FATF in March 2017.[6]

Table 2.1: Ratings on Technical Compliance on Recommendations that impact directly on Financial Inclusion

							FATF Recommendations					
S/N	**Jurisdiction**	**Assessment body/bodies**	**R.1**	**R.2**	**R.3**	**R.4**	**R.5**	**R.6**	**R.7**	**R.8**	**R.9**	**R.10**
1	Armenia	MONEYVAL	PC	LC	LC	LC	LC	LC	PC	LC	C	LC
2	Australia	FATF/APG	PC	LC	C	C	LC	C	C	NC	C	PC
3	Austria	FATF	PC	PC	LC	C	C	PC	PC	PC	LC	LC
4	Bangladesh	APG	PC	LC	LC	LC	LC	C	LC	LC	PC	LC
5	Belgium	FATF	LC	LC	C	C	LC	PC	PC	PC	C	LC
6	Bhutan	APG	NC	PC	PC	PC	NC	NC	NC	PC	LC	C
7	Canada	IMF/FATF/APG	LC	C	C	LC	LC	LC	LC	C	C	LC

[6] This compilation was published by FATF on 9 March 2017, when nearly no GIABA member State has been assessed against the revised FATF Standards and Methodology. The only exception is Ghana, which was assessed at the beginning of GIABA's Second Round Mutual Evaluations in September 2016. The report of that assessment has not yet been published to ascertain the country's level of compliance.

S/N	Jurisdiction	Assessment body/bodies	R.1	R.2	R.3	R.4	R.5	R.6	R.7	R.8	R.9	R.10
8	Costa Rica	GAFILAT	PC	PC	LC	LC	PC	PC	NC	NC	C	LC
9	Cuba	GAFILAT	LC	C	LC	LC	C	C	LC	PC	C	LC
10	Ethiopia	ESAAMLG/WB	NC	PC	LC	LC	LC	NC	NC	PC	C	LC
11	Fiji	APG	PC	PC	LC	C	PC	NC	NC	PC	C	PC
12	Guatemala	CFATF/ GAFILAT	LC	C	LC	LC	PC	PC	PC	LC	C	LC
13	Honduras	GAFILAT	PC	LC	LC	C	LC	LC	PC	LC	C	LC
14	Hungary	MONEYVAL	PC	PC	LC	C	PC	PC	PC	PC	C	PC
15	Italy	IMF/FATF	LC	LC	LC	C	C	LC	PC	LC	C	LC
16	Jamaica	CFATF	PC	PC	LC	LC	LC	NC	PC	NC	C	PC
17	Malaysia	APG/FATF	LC	C	LC	LC	LC	C	PC	LC	LC	C
18	Norway	FATF	PC	PC	C	LC	LC	PC	PC	LC	LC	PC
19	Samoa	APG	PC	PC	PC	LC	PC	PC	NC	PC	C	PC
20	Serbia	MONEYVAL	PC	LC	LC	LC	LC	PC	NC	PC	LC	PC
21	Singapore	FATF/APG	LC	C	LC	C	LC	LC	LC	LC	C	C
22	Spain	FATF	C	LC	LC	C	LC	PC	PC	LC	C	LC
23	Sri Lanka	APG	PC	PC	LC	PC	C	LC	NC	PC	LC	NC
24	Switzerland	FATF	LC	LC	LC	LC	LC	LC	C	PC	C	PC
25	Trinidad and Tobago	CFATF	PC	LC	LC	LC	C	PC	NC	NC	C	LC
26	Tunisia	MENAFATF/ WB	PC	PC	C	LC	C	PC	NC	LC	C	PC
27	Uganda	ESAAMLG	NC	PC	PC	LC	NC	NC	NC	NC	C	PC
28	United States	FATF/APG	PC	C	LC	LC	C	LC	LC	LC	C	PC
29	Vanuatu	APG	NC	NC	NC	PC	PC	PC	NC	NC	LC	PC
30	Zimbabwe	ESAAMLG	PC	LC	C	PC	C	C	NC	NC	C	PC
				C	Compliant							
				LC	Largely compliant - There are only minor shortcomings.							
				PC	Partially compliant - There are moderate shortcomings.							
				NC	Non-compliant - There are major shortcomings.							
				NA	Not applicable - A requirement does not apply, due to the structural, legal or institutional features of the country.							

Table 2.2: Ratings on Effectiveness

			Immediate Outcomes (IOs) on Effectiveness										
S/N	Jurisdiction	Assessment body/bodies	IO-1	IO-2	IO-3	IO-4	IO-5	IO-6	IO-7	IO-8	IO-9	IO-10	IO-11
1	Armenia	MONEYVAL	ME	SE	ME	SE	SE	ME	LE	LE	SE	SE	SE
2	Australia	FATF/APG	SE	HE	ME	ME	ME	SE	ME	ME	SE	ME	SE

S/N	Jurisdiction	Assessment body/bodies	IO-1	IO-2	IO-3	IO-4	IO-5	IO-6	IO-7	IO-8	IO-9	IO-10	IO-11
3	Austria	FATF	ME	SE	ME	ME	ME	LE	LE	ME	SE	ME	SE
4	Bangladesh	APG	ME	SE	ME	LE	LE	ME	LE	LE	SE	ME	SE
5	Belgium	FATF	SE	SE	ME	ME	ME	SE	ME	ME	SE	ME	ME
6	Bhutan	APG	LE	ME	LE	LE	LE	LE	LE	LE	ME	LE	LE
7	Canada	IMF/FATF/APG	SE	SE	SE	ME	LE	ME	ME	ME	SE	SE	ME
8	Costa Rica	GAFILAT	ME	SE	ME	ME	LE	ME	ME	ME	ME	LE	LE
9	Cuba	GAFILAT	ME	ME	SE	ME	SE	ME	ME	SE	SE	SE	ME
10	Ethiopia	ESAAMLG/WB	LE	ME	LE	LE	ME	LE	LE	LE	LE	LE	LE
11	Fiji	APG	ME	ME	ME	ME	LE	ME	ME	LE	LE	LE	LE
12	Guatemala	CFATF/ GAFILAT	ME	SE	ME	ME	ME	SE	SE	SE	ME	ME	ME
13	Honduras	GAFILAT	ME	SE	ME	ME	LE	ME	ME	HE	SE	ME	LE
14	Hungary	MONEYVAL	LE	SE	ME	ME	LE	SE	LE	LE	ME	ME	ME
15	Italy	IMF/FATF	SE	SE	ME	ME	SE	SE	SE	SE	SE	ME	SE
16	Jamaica	CFATF	ME	ME	ME	LE	LE	ME	LE	SE	LE	LE	LE
17	Malaysia	APG/FATF	SE	ME	SE	ME	ME	SE	ME	ME	ME	SE	ME
18	Norway	FATF	ME	SE	ME	ME	ME	ME	ME	ME	SE	ME	ME
19	Samoa	APG	ME	SE	LE	ME	ME	LE	LE	ME	ME	ME	LE
20	Serbia	MONEYVAL	ME	ME	ME	ME	ME	ME	LE	ME	ME	LE	LE
21	Singapore	FATF/APG	SE	SE	ME	ME	ME	SE	ME	ME	LE	ME	SE
22	Spain	FATF	SE	SE	SE	ME	SE	HE	SE	SE	SE	ME	ME
23	Sri Lanka	APG	ME	LE	LE	LE	LE	LE	LE	LE	SE	LE	LE
24	Switzerland	FATF	SE	ME	ME	ME	ME	SE	SE	SE	SE	SE	SE
25	Trinidad and Tobago	CFATF	ME	ME	ME	ME	ME	ME	LE	LE	LE	LE	LE
26	Tunisia	MENAFATF/ WB	ME	ME	LE	LE	LE	ME	ME	ME	LE	LE	LE
27	Uganda	ESAAMLG	LE	LE	LE	LE	LE	LE	LE	LE	LE	LE	LE
28	United States	FATF/APG	SE	SE	ME	ME	LE	SE	SE	HE	HE	HE	HE
29	Vanuatu	APG	LE	LE	LE	LE	LE	LE	LE	LE	LE	LE	LE
30	Zimbabwe	ESAAMLG	LE	LE	LE	LE	LE	LE	LE	LE	ME	ME	LE

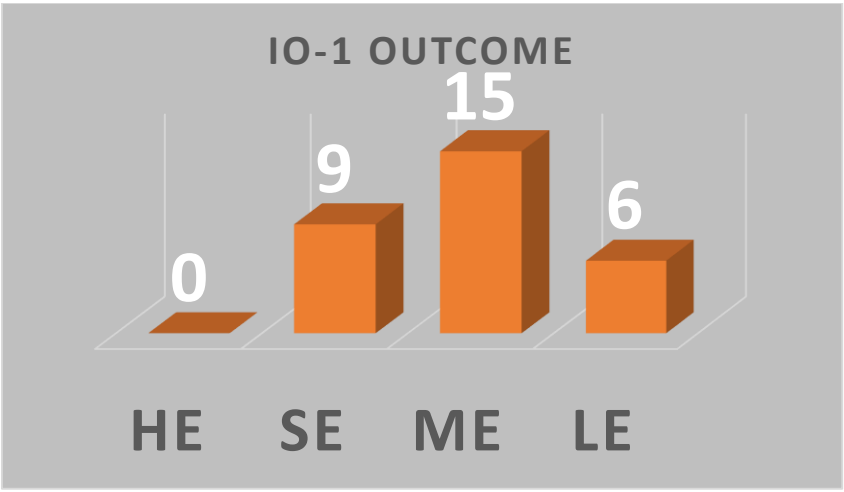
HE	High level of effectiveness - The Immediate Outcome is achieved to a very large extent. Minor improvements needed.
SE	Substantial level of effectiveness - The Immediate Outcome is achieved to a large extent. Moderate improvements needed.
ME	Moderate level of effectiveness - The Immediate Outcome is achieved to some extent. Major improvements needed.
LE	Low level of effectiveness - The Immediate Outcome is not achieved or achieved to a negligible extent. Fundamental improvements needed.

32. Tables 2.1 & 2.2 above demonstrate the persistence of the handicap faced by advanced countries, mostly FATF members, in harnessing the flexibilities of the FATF standard to meet the conditions for achieving effective CDD implementation and financial inclusion as mutually reinforcing objectives. In Table 2.1, out of the 30 countries assessed, only 3 have been able to achieve compliance with the Recommendation on CDD (Recommendation 10). While 13 of them were largely compliant, 13 were only partially compliant. On the aggregate, this performance shows that mitigating ML/TF risks through effective CDD implementation is still a challenge even

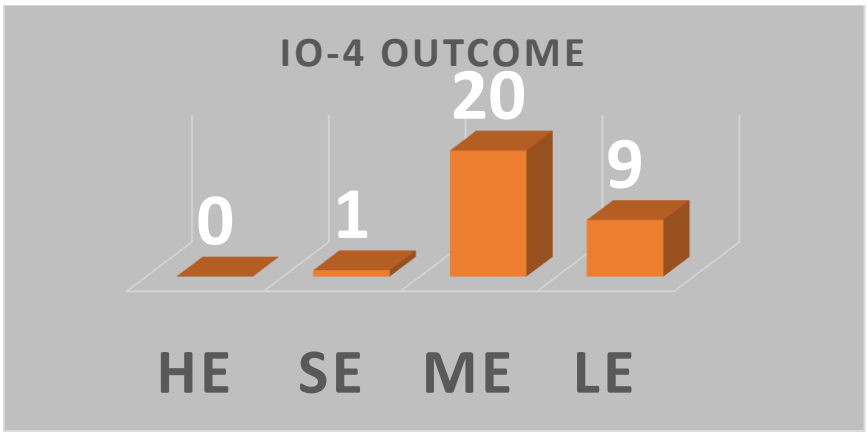
in high capacity countries, and suggests a worse scenario in the low-capacity region of GIABA member States.

33. Further still, of the 3 countries that were compliant with the requirements of the standard on CDD, 1 (Bhutan) is non-compliant on Recommendation 1 (Risk Assessment). Assessing and understanding one's AML/CFT risks is a prerequisite for adopting the RBA to implementing CDD measures in a flexible manner that allows for financial inclusion. Compliance with R.10 combined with failure to comply with R.1 is, therefore, an indicator of indiscriminate application of CDD measures, which is highly likely to undermine financial inclusion, thus limiting regulation to the formal financial sector.

34. Table 2.2 shows the effectiveness of the measures implemented by the countries assessed. The Immediate Outcomes directly relevant for effective preventive (CDD) measures while expanding financial inclusion are IOs 1 and 4. The global performance on these outcomes has been less than impressive. Out of the 30 countries assessed, none (0) achieved high effectiveness (HE). While 9 achieved substantial effectiveness (SE) and 15 achieved moderate effectiveness (ME). The remaining 6 scored low effectiveness (LE). IO 1, particularly Core Issue 1.3, allows for the proper use of the results of ML/TF risk assessment to justify the application of enhanced CDD measures for higher risk cases, or simplified measures for lower risk cases. The unimpressive performance on the effectiveness of this outcome means that, world over, countries are struggling to harness the flexibility promised by the FATF revisions, and that implementing effective ML/TF preventive measures in the context of financial inclusion remains a herculean task.



35. On IO 4, the story is no less unimpressive. Only 1 country scored SE out of 30 countries, with none achieving HE. 20 countries achieved ME and remaining 9 fell into the category of LE. Again, the widespread mediocre performance on this Immediate Outcome underscores the continued contradictions in the quest for effective preventive measures and financial inclusion as mutually reinforcing objectives.



36. A serious consequence of not properly understanding and applying the RBA as a preventive measure is the over-simplification or permissive implementation of CDD requirements. Such a skewed approach promises to accelerate financial exclusion, while increasing the risks of ML/TF. The corollary of this, and perhaps with heavier gravity, is the tendency to become risk-averse and switch off access to financial services by clients that cannot meet CDD requirements, regardless of how stringent they may be. This behaviour is captured by the concept of 'de-risking', a situation where financial institutions terminate or restrict business relationships with entire countries or classes of customers in order to avoid, rather than manage, risks in line with the FATF's RBA. The inexorable effect of de-risking practices includes heightened financial exclusion, which, in turn, undermines *effective* AML/CFT implementation as it pushes high-risk clients to informal or semi-formal service providers that are either not subject to AML/CFT supervision or lack the capacity to adequately apply the required AML/CFT measures.

37. Various explanations have been advanced for this misunderstanding and the misapplication of the RBA. Some of the identified factors include ambiguity and immense subjectivity inherent in the RBA (Durner & Shetret 2015: 6); the lack of clear guidance on how to calibrate due diligence to the scale of social risks; and over-reliance on strong customer identification documents, which are hard to come by in many developing countries (Center for Global Development 2016: 27). For FinMark Trust (2015: 14), financial institutions may display "overly conservative compliance" or "over compliant" responses for various other reasons. These include business management processes that support conservative compliance responses for a number of factors, including an institutional compliance culture, a conservative approach to risk in the industry, a need for uniformity in business management processes, lack of compliance management expertise, foreign compliance examples that inform local compliance responses, concern about penalties and sanctions, the desire to maintain a good relationship with regulators and supervisors, a belief that the supervisor is intolerant of compliance errors, law that is uncertain, appropriate management of other risks that may require a conservative approach, and business information systems that may dictate a conservative response. With respect to developing countries, Trust has argued that the peculiar problem has been the adoption of the AML/CFT templates of advanced countries without serious domestic policy input.

38. Unfortunately, there is a dearth of literature on these questions covering West Africa. While there is considerable research on financial inclusion in the region, the studies were mostly on other subject matters rather than on CDD implementation by Member States, or on the links between

the two subjects. The status of CDD implementation in GIABA countries could be gleaned from the reports of the assessment of member States conducted during the First Round of mutual evaluations, although they were done against the old FATF Standard where the conditions in the new standard for linking CDD implementations and financial inclusion were non-existent. The findings from this pioneering study will fill the research gap. The outcome will be a pioneering work on the subject and, hopefully, provoke further inquiry. Further, GIABA has only commenced the evaluation of the AML/CFT regimes of its member States using the revised FATF Recommendations and Methodology. As more countries are evaluated, in a few years we will be able to understand the extent to which they have been able to adopt preventive measures in the context of financial inclusion.

39. In summary, while the introduction of the global AML/CFT compliance framework by the FATF has done a lot to protect and enhance the integrity of the international financial system, it has also, in some ways, hampered financial inclusion. This was largely caused by the misapplication of the standard by countries rather than by the standard itself. However, the initiative taken by the FATF to make the standard more flexible and to hold countries responsible for the effectiveness of their AML/CFT systems or otherwise makes it easier to account for good and bad practices that will promote or hamper financial inclusion. In the end, it must be noted that the AML/CFT compliance framework is based on standards that hinge on a fundamental assumption that countries will clearly and comprehensively identify their ML/TF risks, ineptly analyse those risks and understand how they interact with the real world and the likely harm they can cause, following which they will then take appropriate measures, based on priority, to mitigate the risks across the AML/CFT landscape in their countries. Failure to have a valid and reliable risk assessment will render the RBA invalid, and when the RBA is invalid, the risk considerations required for KYC-CDD and other related financial inclusion measures will equally be invalid and off target. This means that the FATF and all the stakeholders with interest in the global AML/CFT compliance framework must continue to keep watch of developments as the implementation of the new standard and its assessment unfold. It is worth highlighting that using the RBA in AML/CFT implementation may help countries to build a more inclusive financial system by allowing financial institutions to apply certain simplified AML/CFT measures to clients that may present lower ML/TF risks. This can prevent having excessive, disproportionate and unnecessary requirements, including those that may hinder access to appropriate services for the under-served groups. By increasing financial inclusion, this can reduce the scope of transactions conducted through the informal financial environment, which are not subjected to regulatory and supervisory oversight.

SECTION 3

Legal and Regulatory Frameworks and Supervisory Practices in West Africa

Introduction

40. In pursuit of the mutually reinforcing objective of financial integrity and financial inclusion, the legal and regulatory framework is paramount. For a financial sector to be buoyant and sustainably stable, the legal instruments that lay the foundation of the regulatory and supervisory responsibilities should be adequate and in line with global standards. Such framework should be reflective of the legal proviso and international standards and best practices, while being mindful of the domestic environment.

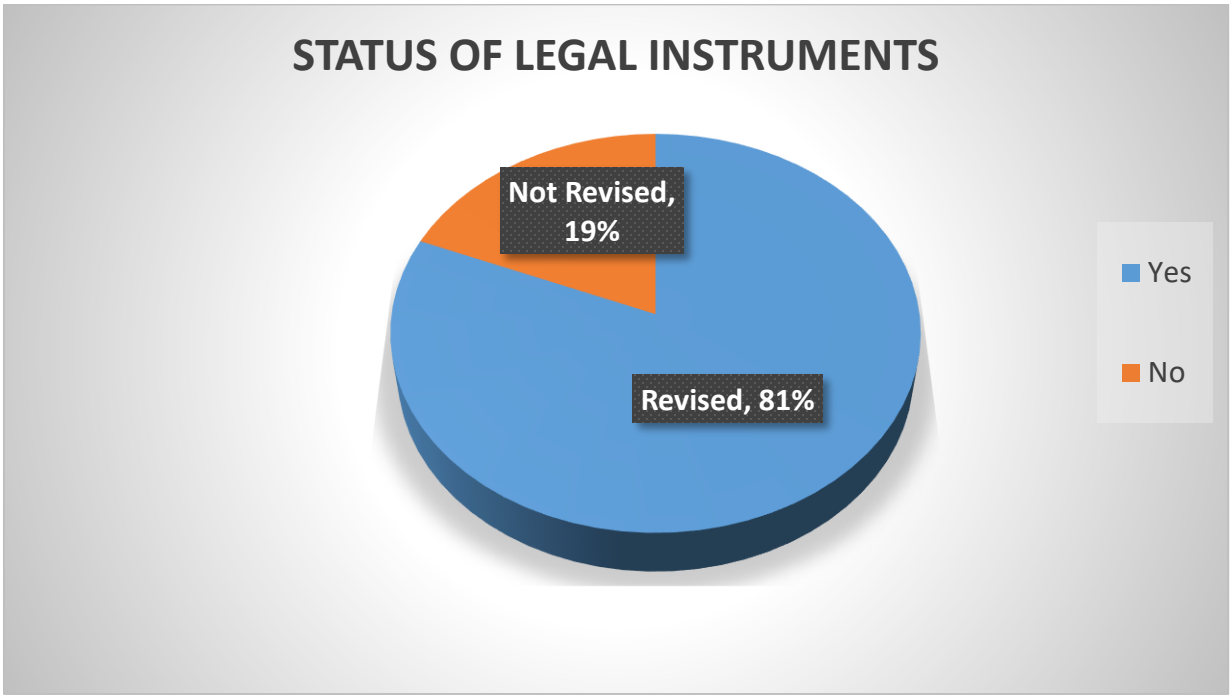
The Legal and Regulatory Environment

41. The sub-sectors that are under the purview of the regulatory authorities for anti-money laundering and counter terrorist financing comprise of the banks, insurance, securities, microfinance, bureau de change, money and value transfer services (MVTS), mobile money, investment finance, mortgage finance, rural finance, etc. Although there are other financial arrangements in the region that operate outside the purview of state regulation and outside the scope of this study; the aforementioned are those that were considered in this study.

42. The various laws and other legal frameworks put in place to regulate and supervise/monitor the regulated/supervised institutions range from sector specific acts (e.g., the banking act), to sector regulatory act (i.e., central bank act) and the AML/CFT act. Some of the instruments have been in force since 1991 and some are as recent as 2016. Most of the earlier instruments were revised, to capture recent trends and best practices. Out of the population surveyed, 81% of respondents reported that the legal instruments that guide their operations were revised in the last decade. The remaining 19% represents newly developed or created sectors in the member States. The securities sector is a case in point in some member States. Below is a chart that presents the status of legal instruments in the region.

43. All the text provided by the regulators and supervisors confirm, in principle, the strict implementation of AML/CFT standards, particularly on the conduct of know-your-customer/customer due diligence (KYC-CDD) measures. These are strongly reinforced in the guidelines developed.

Figure 3.1: Status of Legal Instruments that Govern the Financial sector in West Africa

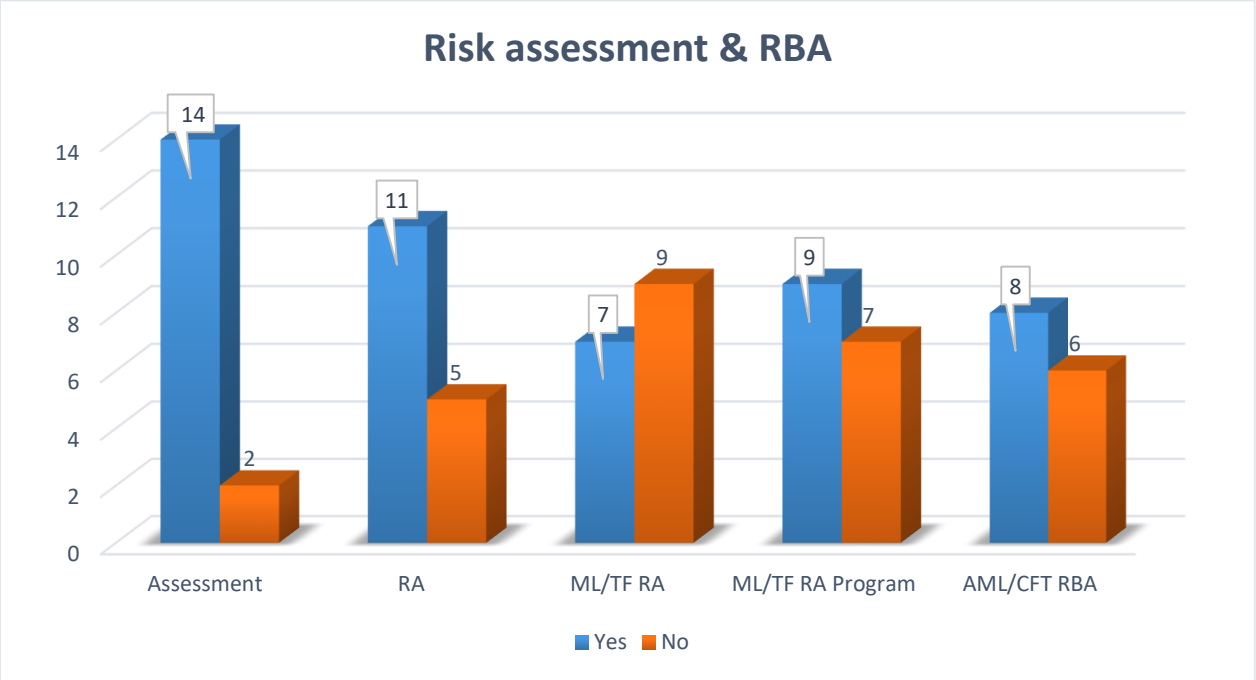


44. The legal and regulatory/supervisory frameworks in most member States lack the flexibility required to enable financial services providers to implement the RBA when conducting KYC-CDD. When asked on whether the regulators have conducted any form of assessment or risk assessment, 88% answered "yes". However, only 56% stated that they have ML/TF risk assessment programme in place, and 57% have an AML/CFT RBA program as well. When the same question was restated as to whether they have conducted ML/TF risk assessment, only 44% responded in the affirmative, reflecting some inconsistencies. Table 3 and Figure 2 below provide the details. This contradictory response shows a widespread lack of sound understanding of the RBA, a measure required for flexibility in the implementation of KYC-CDD measures.

Table 3.1: The Conduct of Risk Assessment and Implementation of the RBA by Financial Operators

RISK ASSESSMENT AND THE RISK-BASED APPROACH RESPONSES					
	Assessment	**Risk Assessment**	**ML/TF Risk Assessment**	**ML/TF RA Program**	**AML/CFT RBA**
Yes	**88%**	**69%**	**44%**	**56%**	**57%**
No	**13%**	**31%**	**56%**	**44%**	**43%**

Figure 3.2: The Conduct of Risk Assessment and Implementation of the RBA by Financial Operators in West Africa



45. The legal and regulatory framework for the establishing and operating formal financial services are robust and meet required standard in most of the member States, regardless of whether the business is registered as indigenous/local or regional/international. The reason being that the business can be registered as indigenous, but the shareholders/owners/beneficial owners can be either foreigners who are resident in the country or abroad, or natives of the country resident at home or abroad.

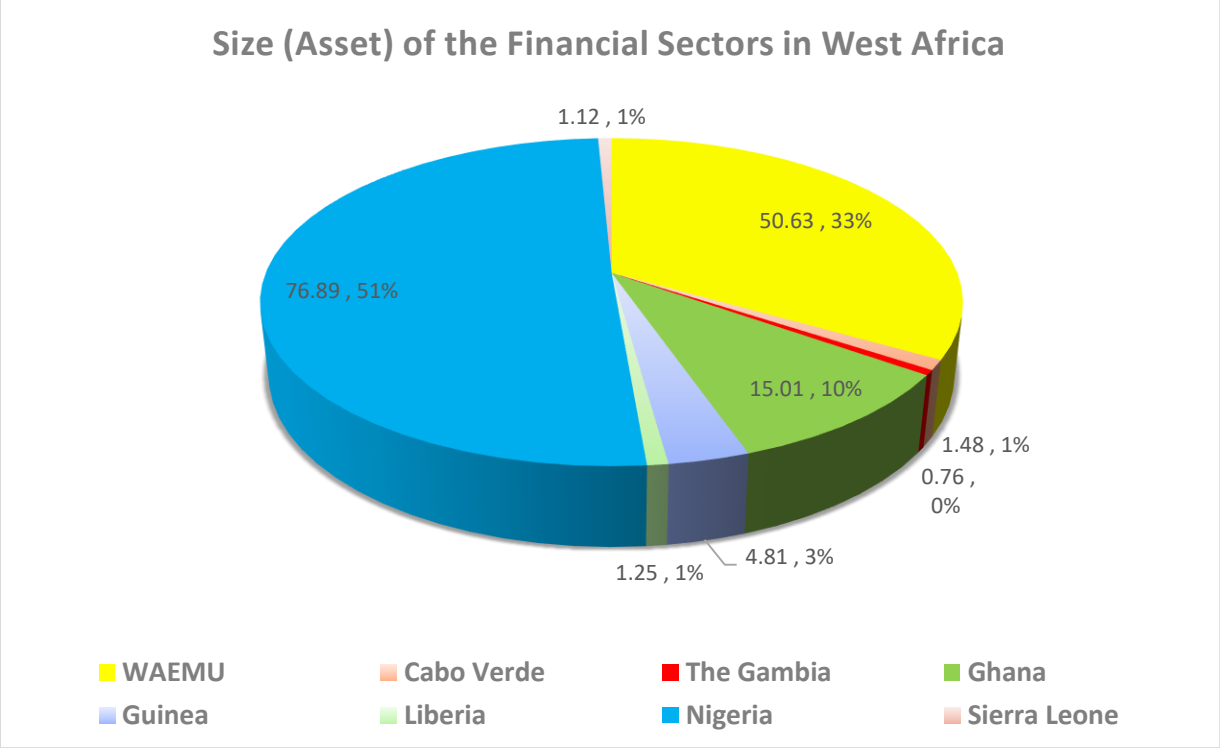
46. Supervisors alluded to the fact that during their routine examination or targeted spot checks on banks, inspection teams randomly and often look at the clientele lists and review the respective service providers' policies against the requirement in the AML/CFT guidelines and/or assess their level of compliance with the AML/CFT act. This is however, not the case for some insurance supervisors in the region; they admitted that they have not been assessing KYC-CDD implementation by service providers. This is largely because, most of the insurance companies were previously supervised by the central banks and for smaller economies that is still the case. However, countries that have created insurance regulatory bodies independent of the central bank are still on the learning curve, taking teething steps to find their feet – it remains a serious challenge in those economies.

47. With the exception of the Central Bank of Nigeria (CBN), which conduct AML/CFT policy impact assessment, most regulators in the region still rely on the traditional onsite and offsite method of supervision when assessing AML/CFT compliance of service providers. In addition to performing ML/TF risk assessment, only 55% of regulators claimed that they do conduct ML/TF risk assessment on products/services offered by operators, whether these products are new or

products reintroduced with additional features or re-assessed ones. This points to the weaknesses in risk based supervision in the region.

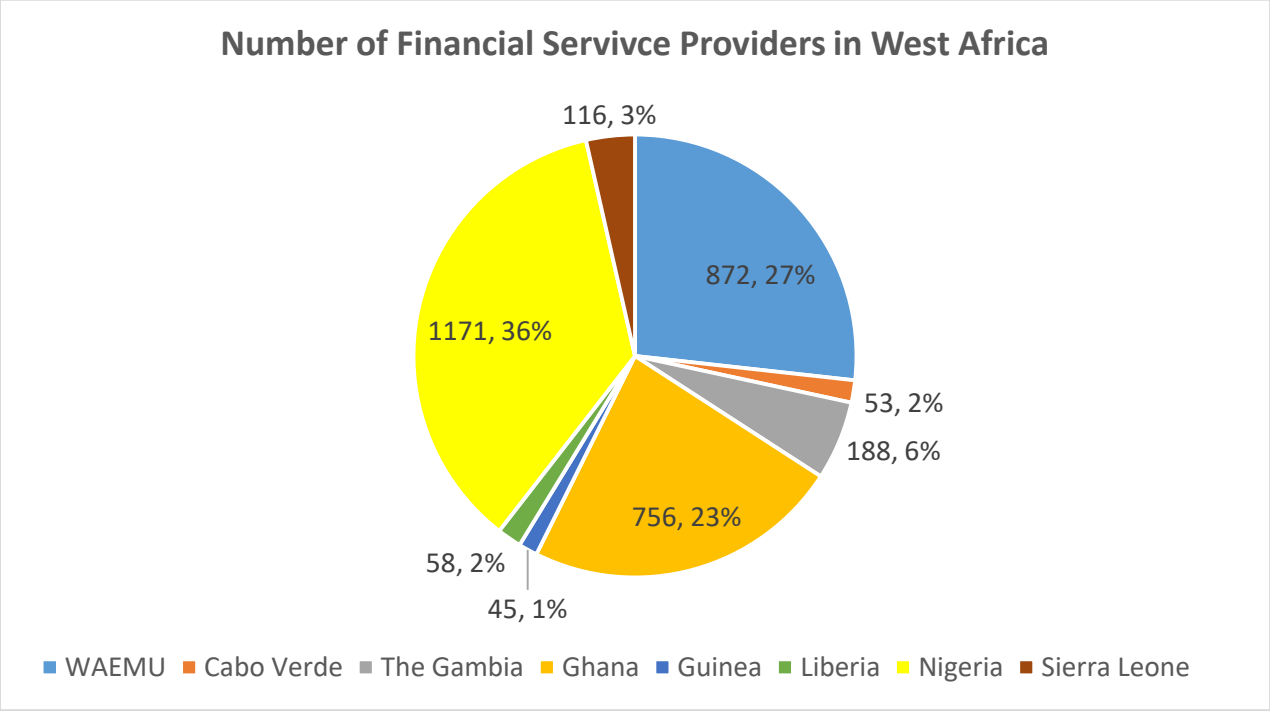
48. The financial sector is key to the regions' economic development, in terms of its contribution to overall growth, job creation, poverty alleviation and government revenue, etc. The West Africa financial sector contributes an average of 30% of the regions' GDP (GIABA, 2014), and 90% of the sector is comprised of mainly money deposit banks. This is very much evident in the responses given by the respondents on the size of the sector, which mirrors the importance and possible impact or consequence the banking sector could pose to the economy if its stability is undermined. While the banking sector is more than 90% of the financial sector, the insurance sector is averaging at 1% of the GDP in the region. It depicts how much need to be done to promote insurance in particular and other financial services in general in order to widen and deepen inclusion.

Figure 3.3: Size (Assets) of the Financial Sector in West Africa ($billion)



49. The responses also revealed how the financial sectors of smaller economies are mostly dominated by leading regional players who control about two-third of the market, more evidently in the banking sector. This is not the case with respect to the bigger economies in the region. Such dominance gives lead industry players the edge to dictate trends in the market, while the indigenous and smaller operators which are followers in the market have little choice but to play along. The leading industry players have both marginal and average cost advantages, and are more aggressive in their operations and generally have stronger compliance frameworks as an inherent asset from their parent companies, with state-of-the-art infrastructure and attracting the highest quality of human resources. In most cases, the leading industry players are ahead of their domestic regulators, supervisors, in terms of expertise.

Figure 3.4: Number of Financial Institutions in West Africa



50. The table below shows the various financial products in the region, as categorized. Although it appears that most financial products and services are provided in specific parts of the region, the bulk of the financial products and services provided are limited to the traditional ones (column 1&2 below). The last 3 columns largely represent financial inclusion products and services. Apart from remittances, majority of the products and services provided by financial intermediaries, as identified under the financial inclusion categories, account for the bulk of the volume of transactions in the sector. However, these categories account for less than one-fourth of the transaction value in the sector. Hence the need to redirect more funds into these categories, which have the highest growth potentials.

Table 3.2: Financial Products and Services in West Africa

Retail Banking	Trade Financing/ Investment	Securities/ Treasury Operations	Insurance	Microfinance	Remittance /Foreign Exchange	Electronic finance
Payment services (cash and bills)	Letters of Credit services	Buying and selling of bullion and foreign exchange	Life (long term) insurance	Cash payments	Remittances and money transfer service	Mobile money
Savings, term and demand deposits	Bills of exchange, promising notes, drafts, bills	Acquiring, holding, underwriting and dealing in shares,	General (non-life) insurance on accidents,	Savings deposit	Buying and selling of foreign currencies	Prepaid debit and credit cards

Retail Banking	Trade Financing/ Investment	Securities/ Treasury Operations	Insurance	Microfinance	Remittance /Foreign Exchange	Electronic finance
	of lading and other securities services	debentures, etc.	damages and natural disaster			
Cash credit, overdraft, mortgage and term loans	Leasing and factoring services	Purchasing and selling of bonds and securities on behalf of constituents		Credit and overdraft		ATM and PoS
Negotiations for loans and advances, Financial Advisory services, Deposit box services, etc.				Transfers		Internet/ online banking

51. A review of the growth trends in the last five years (2012 to 2016), revealed that there are no significant changes in the number of service providers operating in the various economies reported; most of the growth in this area happened before 2012, and the sector has been steady for the most part except for the microfinance and bureau de change sub-sectors, which recorded significant growth. The same trend also holds for industry client base. However, there has been slight growth on turnover in the preceding years of 2016, which could also be explained by exchange rate fluctuations and recent inflation trends. The exceptions here also are the new growth sectors of microfinance (including mobile money), bureaus and remittances.

52. In the areas of collaboration between and among state AML/CFT authorities for promoting and enforcing compliance, most of the respondents reported the existence of close and healthy collaboration and cooperation. This is particularly evident between the central banks and FIUs. Again, the microfinance and bureaus reported otherwise, rating collaboration to be below average. This is a serious challenge for these emerging growth sectors, which have even greater potentials in reaching out to the unbanked and underserved.

53. Member States' governments have prioritized the development of their financial sectors, including enhancing financial stability and integrity. The last decade has witnessed the development of financial sector blue prints in most of the economies. In addition to that, after the Maya Declaration, several member States that were party to the convention have further developed a financial sector strategy to promote financial inclusion and integrity simultaneously. Mirroring this commitment, most member States affirmed that they have developed a guideline or guidance note directed towards promoting good practices that serve the mutually reinforcing goals of

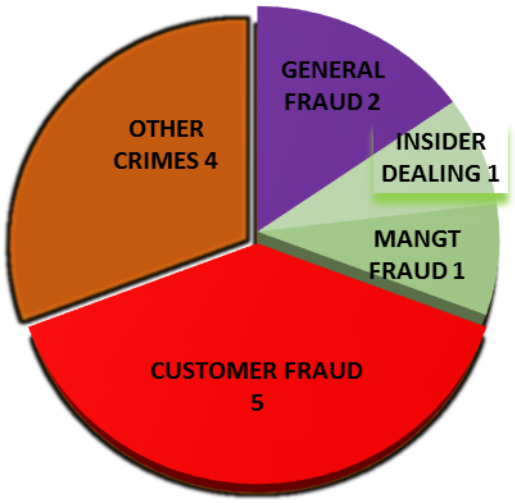
financial integrity and financial inclusion. In spite of this effort, however, the awareness on these issues has been below average.

54. A KYC-CDD framework has been developed by all countries in the region, though not for every sub-sector as stated earlier. However, the implementation of the framework has been at varied levels, ranging from 1 (the lowest) to 5 (the highest). In the area of having in place a RBA guidance framework, apart from Ghana and Nigeria that have adequately addressed this issue, all the other member States are yet to do so. Some of them either have a draft document in the form of framework, which is yet to be approved for implementation, or have nothing at all. Again, in responding to whether the RBA as implemented is based on some form of risk assessment, Ghana and Nigeria responded in the affirmative, rating the industry risk assessment process adequate and robust[7]. As reiterated in the literature, the KYC-CDD framework, vis-à-vis the implementation of the RBA, is sine qua non to the promotion of financial integrity and financial inclusion.

55. A snapshot of the industry with regard to the business environment, the manner in which service providers conduct themselves and the general crime level shows mixed responses, with mostly moderate outlook. With regards to the business climate, the responses, for the most part, have been favourable with much improvement, thanks to member States' effort in implementing their various financial inclusion strategies. The financial operators have also measured up in the same vein in terms of comportment and maintaining high compliance level, sometimes higher than expected. Though it is a good thing for operators to imbibe and maintain a high compliance habit, however, a compliance appetite that is higher than what is expected of them and is non-commensurate to the risks associated to products and client defeats the purpose of the mutual goal of attaining financial integrity and financial inclusion.

56. In terms of crime level, including general fraud, insider dealing, shareholder/management fraud and customer fraud, the chart below depicts the observed trend, which cut across all the sectors in the region.

Figure 3.4: A Self-Assessment by Regulators on the Crime Level in the Financial Sector



[7] Not all the WAEMU member States have adopted the revised 2016 legislation that addresses the issue of risk assessment and the RBA.

57. It is widely accepted that customer fraud and other types of frauds such as e-Card theft and cloning, are moderately high and very much present, while insider dealing and management fraud is low or contained. It is also worth stating that traditional financial products are even more exposed to fraud than emerging products with financial inclusion potentials. Therefore, while countries can continue to ensure the provision of traditional financial products, it is important for them not to be seen standing in the way of newly created technological and innovative products that have financial inclusion solutions.

58. Service providers are learning fast in order to stay competitive and are willing and ready to widen their scope with regard to developing new financial products, including technologically driven ones. However, this is not the case for most of the regulators in the region. Regulators and supervisors seem to be progressing at an arithmetic pace while the operators are progressing geometrically. Due to the fact that regulators enjoy monopoly of control in their various subsectors, they do not have the urge to step out of their comfort zones to keep up with the pace of change in the industry.

59. It is important for regulators and supervisors to fully understand the new operational paradigm and to come to terms with it. The operators are facing more competition as the world is more than ever becoming a common financial space. The service providers are very much feeling the heat. The stake are getting even higher, as financial services are confronted with the parallel financial market in the grey economies which are growing in the region, and many operators are losing their correspondent relationships with their partners abroad due to de-risking. Also, high on the FATF agenda is the issue of Financial Technology (Fintech) and Regulatory Technology (Regtech); and countries in the region cannot continue to shy away from taking concrete steps to understand their ML/TF risks in order to validate the need to adopt the RBA in reinforcing the dual objectives of promoting financial integrity and financial inclusion. The financial operators are ready to compete globally to provide technologically driven products (Fintech), hence, the region's regulators should step up their efforts to provide regulation for the emerging financial technology. The final objective is to get to the "5Ws", i.e., a win for the customer, a win for the operator, a win for the regulator, a win for the domestic financial economy, and overall a win for the international financial system.

SECTION 4

The Financial Sector, its Operational Environment and Existing Practices in West Africa

Introduction

60. As the international financial landscape become more complex and competitive, coupled with the ever demanding global standards put forward by SSBs in order to ensure integrity, stability and enhance competitiveness in the financial market, financial services providers in low capacity regions such as West Africa are faced with a very daunting task of competing, not only with their domestic peers but also with regional and global companies. At the same time, they are expected to be as compliant as everyone else. As if the dual burden of compliance responsibilities and competing in the global financial space are not enough, there is the expectation on them to respond to the demands of the SSBs, development partners, and governments to ensure inclusion in the delivery of their services. Thus, the financial services space is increasing becoming a boxing room, where companies with the right muscles take down the weak and vulnerable, which in itself has the potential to stifle competition, diversity and growth. This business pressure is a testament to how colossal the consequences are if we fail to pursue the mutually reinforcing goal of financial integrity and financial inclusion as asserted by the literature as reviewed in this report. As stated inter-earlier in this report, the benefit of strengthening financial integrity and financial inclusion include the ripple effect of increased growth both in the financial sector and the macro-economy in general.

Operational Environment of the Financial Sector in West Africa

61. The regional financial landscape is a developing one and can be broadly categorized into banking, insurance, securities, microfinance and rural banking, foreign exchange bureau, and remittance (money and value transfer services) sectors. There are various financial nomenclatures that fall under any one of the various broad categories based on the key products and services offered by them.

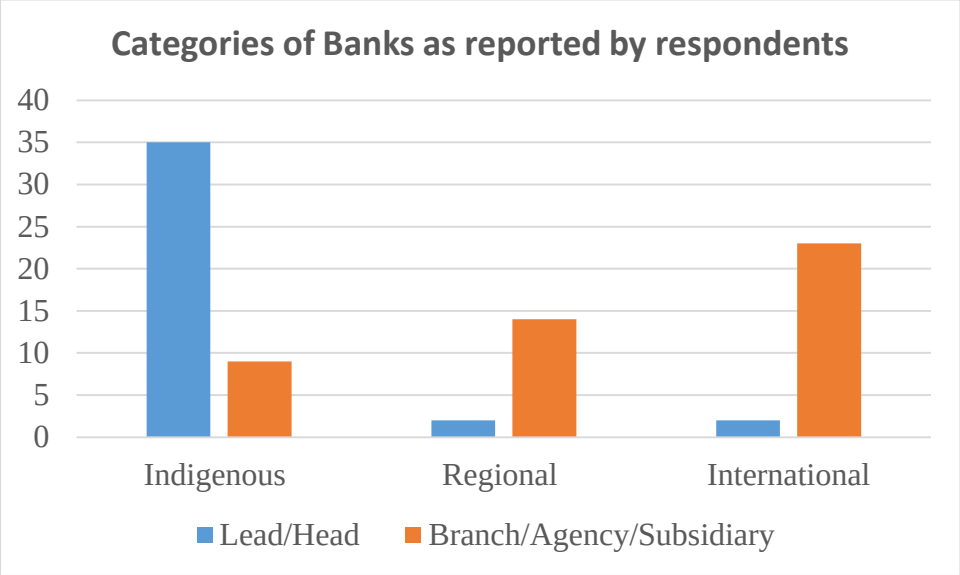
62. The financial entities that responded in the study are registered and licensed, operating within the purview of regulatory and supervisory bodies. The various categories of operators are subject to varied level of regulation and supervision/monitoring. The banking sector is the most regulated and supervised, while the foreign exchange bureaus are the least regulated and supervised. The various regulatory frameworks stem from the legal instruments that created and mandated these bodies to regulate and supervise the sectors. However, the scope of the study, as mentioned earlier, does not include the financial operators in the grey economy.

63. The service providers are further classified by whether they are indigenous, regional or international on the one hand, and lead/head, branch/agency/subsidiary or correspondent, on the other, as the case may be. A classification matrix showing where the various institutions belong is presented below.

Table 4.1: A Classification of Financial Operators (Respondents) in West Africa

Category	Lead/Head	Branch/Agency/Subsidiary	Total
Indigenous	35	9	**44**
Regional	2	14	**16**
International	2	23	**25**
Total	**39**	**46**	**85**

Figure 4.1: Categories of Banks as reported by Respondents



64. The geo-classification of the financial operators (respondents) presented in Table 5 above also largely holds for the sector as a whole. However, it is worth noting that the geo-classification in the WAEMU region defers from what obtains in non-WAEMU countries. In the WAEMU region, a financial operator based within the union is considered by all member States as indigenous/local, while those outside the union are considered international. Also worth noting that 90% of the non-bank financial operators are either local or indigenous.

65. A trend analysis of how the financial operators in West Africa have been performing in the last five years (2012 to 2016) shows a steady growth. Selected financial indicators were considered on both the supply and demand sides. The supply side variables considered were the shareholders' fund, total deposits, loans and advances and premium income, while on the demand side variables considered are the number of transactions, turnover and number of clients/accounts. Apart from some occasional outliers, fluctuation and some downward trends recorded, the overall picture on both demand and supply side variables considered depicted a steady moderate growth. However, the overall increasing trend recorded from the demand side variables were more than proportionate to that of the supply side variables. The more than proportionate increase from the demand side validate the fact that member States policies towards promoting financial inclusion is yielding positive result. Nonetheless, the gains recorded in bringing more people into the formal financial sector have been moderate. Member States may need to adopt more proactive and targeted

measures or at least bolster existing measures in order to achieve substantial level of inclusion relative to the excluded and underserved population.

66. Respondents pointed to the fact that they are operating under the purview of their respective regulatory and supervisory bodies. In Ghana, Nigeria, Sierra Leone[8] and the WAEMU region, the central banks are the regulatory and supervisory institutions for the banks and other financial institutions. The insurance and security sectors are regulated and supervised by separate entities - insurance commission and security exchange commission/capital market regulator, respectively. In the case of Cabo Verde, the Gambia, Guinea and Liberia, the central bank is the sole regulatory and supervisory institution for all financial institutions.

Figure 4.2: Levels of Regulation in West Africa

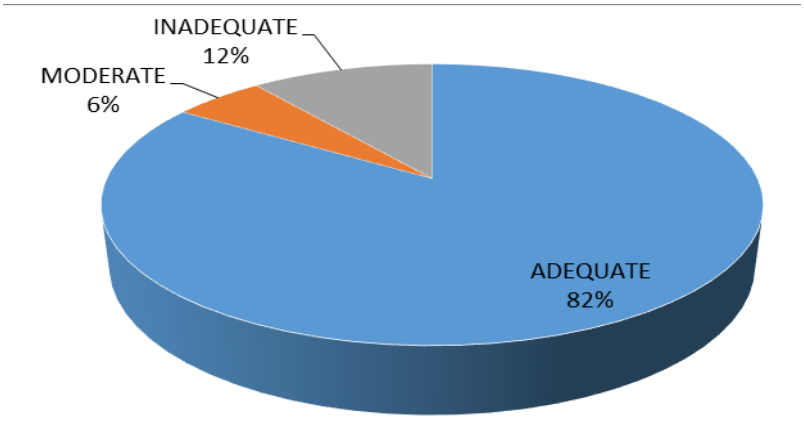
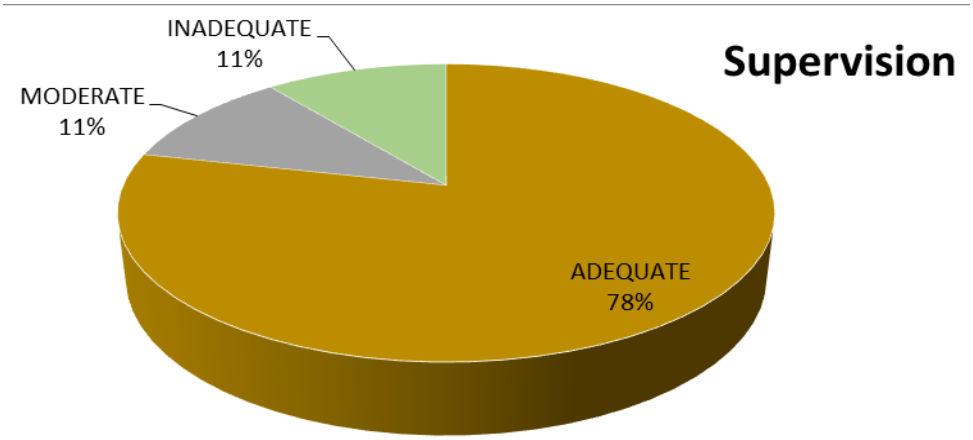


Figure 4.3: Levels of Supervision in West Africa



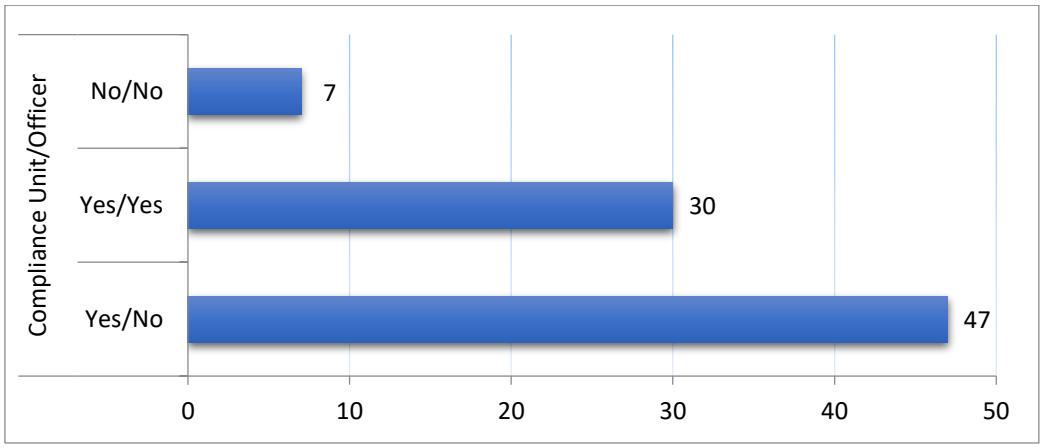
67. From the chat above, 82% of respondents reported that they are adequately regulated, while 12% reported inadequate regulation. The sectors that reported inadequate regulation were mostly operators from the microfinance sector and foreign exchange bureaus. The result is not very much different from what was reported on the adequacy of supervision. Regulators and supervisors need

[8] Though there is an insurance commission and a capital market, these institutions are still very much weak to effectively carryout their functions, particularly if the sectors growth potentials are realise in the short term.

to reach out to and effectively carry along these other sectors due to their potential for enhancing financial inclusion.

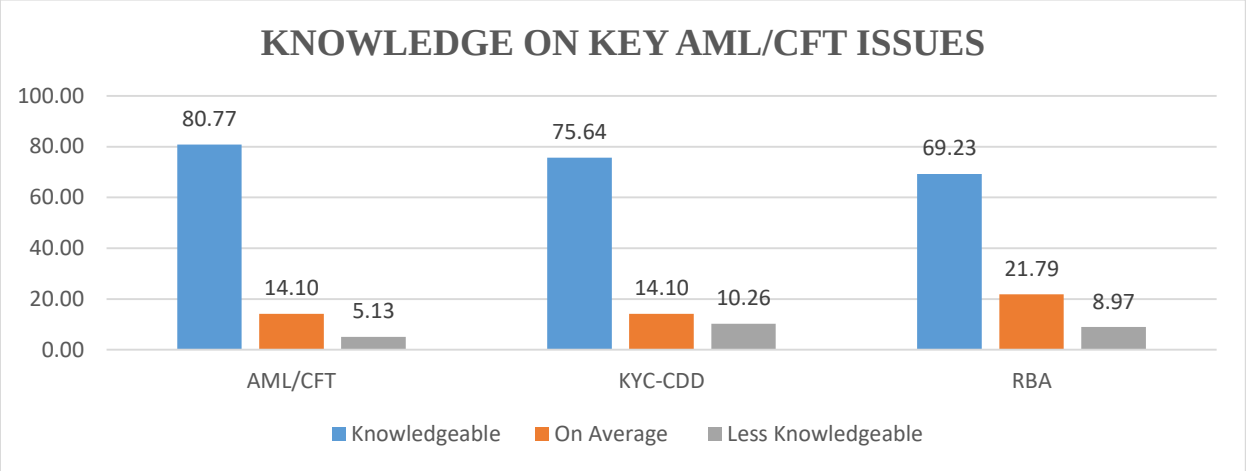
68. A very key component of the compliance framework is the recruitment of a senior official to head the compliance unit by financial institutions. Depending on the institution and the business type, the official is required to be a managerial level staff. Below is a chat showing 92% of the respondents confirming the existence of a compliance unit headed by a very senior official. Only 8% reported not having a dedicated staff for this purpose but that an internal audit or finance officer is performing that role when the need arises. Again, the latter responses came mostly from microfinance operators and exchange bureaus. It is worth noting that out of the 92% that adequately provide for the compliance function, only 39% have separate compliance officials dedicated to AML/CFT compliance.

Figure 4.4: Compliance Unit/Officer in Financial Institutions in West Africa



69. An analysis of the responses given on the knowledge of operators on key AML/CFT issues as depicted in Figure 4.5 below shows that, though the bulk of operators (90% – 95%) are well knowledgeable on AML/CFT issues in general, there is still that important number (5% – 10%) that lack this knowledge, particularly on key components such as the RBA, KYC/CDD. The objective of both regulators and operators is to have an excellent knowledge of these key issues and be well informed on development in the sector at all times and for all categories of operators.

Figure 4.5: Knowledge of Financial Operators on Key AML/CFT Issues in West Africa



70. In response to the question on the provision of guidance, guideline or a formal information on how to conduct customer identification, KYC/CDD and record keeping for AML/CFT purposes, over 90% acknowledged receiving some kind of guidance and guidelines from their regulators and supervisors. However, some of the documents mentioned are not explicitly guidance or guidelines. For example, a copy of the legislation or general regulation provided by operators does not contain specificities of what and how to conduct customer identification and verification and who should be treated as a regular customer and who qualifies for enhanced CDD. Nonetheless, much has been achieved by regulators, supervisors and the executives of financial operators in the areas of training and sensitization, and few countries are developing specific guidance and guidelines. Yet, much more needs to be done in these areas, particularly in countries where the size of the financial sector is small. It is also worth noting that sectors such as microfinance, mobile money service providers and exchange bureaus are receiving very little or no guidance in this direction. There is need for internal collaboration and at the regional level on all sectors in order to share experiences and build capacity.

Existing Financial Practices in West Africa

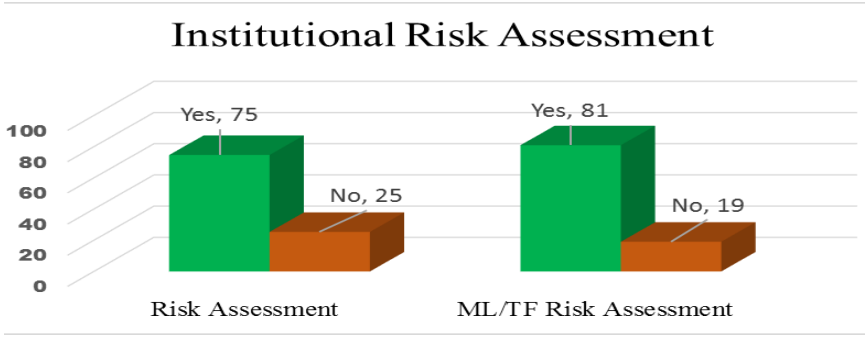
71. An analysis of the existing financial practices in the region gives a mixed picture. There are a number of good practices and there are others that need to be reviewed or discontinued.

72. As noted earlier, it is worth reiterating that implementing RBA for AML/CFT practices can help countries build a more inclusive financial system by allowing financial institutions to apply certain simplified AML/CFT measures where the ML/TF risk is very low. It will avoid having excessive, disproportionate and unnecessary requirements, including those that may hinder access to appropriate services for under-served groups. By increasing financial inclusion, a proportionate approach can reduce the scope of transactions conducted through the informal financial system, away from regulatory and supervisory oversight.

73. On whether the operators are conducting business risk assessment or ML/TF risk assessment, which should be the precursor to adopting the RBA, 75% of the respondents claimed to have conducted business risk assessments, however, 81% reported to have conducted ML/TF

risk assessment. This allude to the fact that the RBA is being adopted without any consideration to the larger national risk, which can only be ascertained through some form of national risk assessment. Again, the trend in countries with weak systems is that indigenous service providers, particularly in the microfinance sector and foreign exchange bureaus, do not conduct risk assessment. This finding tallies with the one on poor regulation and supervision. Considering that financial inclusion is hinged on developing less risky products for the benefit of a large number of people, again, it is critical that these services are adequately regulated and supervised.

Figure 4.6: Financial Institutions Risk Assessment in West Africa



74. The responses on the "application of the RBA" was mixed. Some examples given, though brief, were very clear but others were vague such as KYC requirements for clients. While majority of the respondents claimed that they are applying the RBA in their operations, some of the operators were using the tick-the-box approach for the RBA. This lack of good understanding of the RBA could have contributed to the low level of financial inclusion in most of the countries. For RBA to meet both the technical compliance and effectiveness criteria, the classification framework should be informed by a risk assessment, no matter how elementary it may be. The risk assessment tool should be valid and realistic and subject to independent evaluation.

75. Another reason which supports the notion that most operators are still holding on to the traditional methods of customer identification and verification is the responses given when asked about customer identification practices that they have in place. Almost all the responses reported the traditional customer identification and verification documentations and practices, instead of highlighting different set of customer ID documentations for different risk levels/tiers. The examples put forward of KYC-CDD application are not very much different from the traditional practices, except for a few operators who mentioned the use of customer risk profile, tier system and the risks associated with product or services. This also point to the fact that much more needs to be done in order to make progress in achieving the twin objectives of financial inclusion and financial integrity.

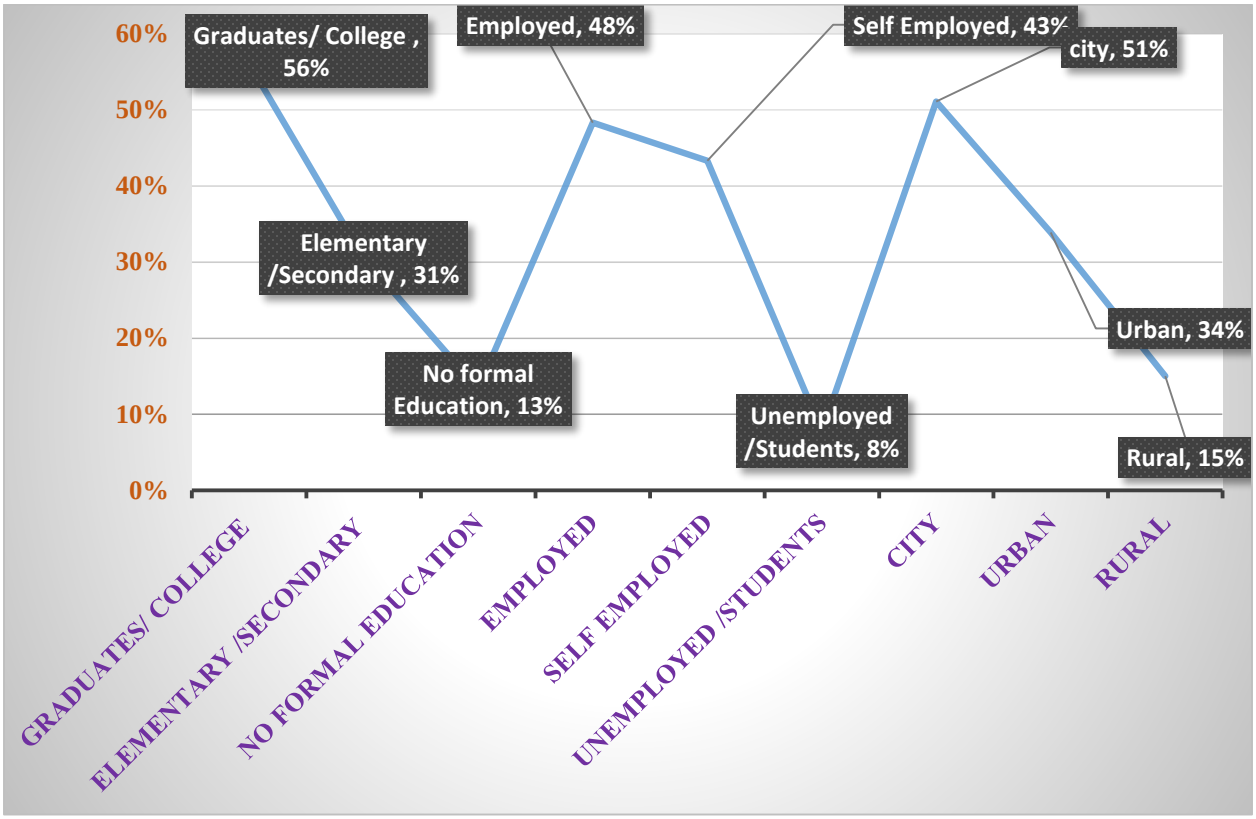
76. The matrix (Table 4.) below presents an analysis of the responses on the status of customers that have access to financial services in West Africa. The analysis considers the customers' level of education, employment status and geographical location. It is evident from the responses that there is a positive relationship between access to finance and the level of education, particularly college and university education. Customers that are gainfully employed and self-employed and

are living in the cities and urban townships have more access to financial services than other categories of customers. As the graph below presenting the averages of the countries surveyed shows, people with no formal education, who are unemployed and are living in rural areas are the most disadvantaged when it comes to benefitting from formal financial services, or to put it simply, they are the most excluded population. Unfortunately, this group of people represent a sizeable number of those who need to be brought into the formal financial system. It appears as if the financial institutions are picking and choosing who to give access to their services, most likely, based on two critical business considerations - profitability and risks. Education and employment appear to be the two most critical factors in financial inclusion regardless of the location of a person.

Table 4.2: Characteristics of Customers Having Access to Finance in West Africa

	LEVEL OF EDUCATION			**EMPLOYMENT STATUS**			**GEOGRAPHICAL LOCATION**		
	Graduates/ College	Elementary /Secondary	No formal Education	Employed	Self Employed	Unemployed /Students	city	Urban	Rural
Benin	75%	5%	20%	35%	55%	10%	30%	45%	25%
Burkina Faso	65%	25%	10%	50%	40%	10%	65%	15%	20%
The Gambia	35%	45%	20%	40%	55%	5%	15%	75%	10%
Ghana	80%	15%	5%	55%	40%	5%	70%	25%	5%
Guinea	30%	45%	25%	50%	45%	5%	40%	55%	5%
Liberia	45%	45%	10%	50%	45%	5%	50%	20%	30%
Nigeria	50%	40%	10%	40%	40%	15%	60%	30%	10%
Sierra Leone	40%	45%	15%	50%	40%	10%	60%	20%	20%
Togo	85%	10%	5%	65%	30%	5%	70%	20%	10%

Figure 4.7: Averages of the Data on the 9 Countries Reported



77. It is also evident that with the implementation of the Maya declaration, which led to the development of financial sector strategies in most of the member States, including rural banking and microfinance targeting agriculture and small and medium businesses, there is an increase in access to financial services for those categories that were beforehand excluded in the financial realm, particularly market women. Yet, access to financial services, and finance for that matter, is more skewed to the elites in the cities and urban townships. There is the need to adopt policies targeting the underserved populations, with limited access to financial services – the unemployed, students, those with no formal education, and those living in impoverished rural communities, including migrant communities.

78. On the potential of the sector, the responses were that access to finance is averaging between 10% and 30% in ECOWAS member States, and this is largely skewed towards banking products and services. There is huge potential for rapid progress in enhancing financial inclusion if innovative and inclusive policies, targeting the majority of the unreached and underserved, are designed by governments, in collaboration with relevant stakeholders. There is a consensus that if such a potential is well tapped into, this will lead to economic growth and poverty alleviation and will address unemployment in the region.

79. Several challenges were highlighted by the operators with regard to obstacles on improving access to financial services, with agreement on the following issues:

i. Inadequate and disproportionate sanction for non-compliance by regulators and supervisors;
ii. Lack of a common agreement among State authorities on the implementation of financial inclusion measures – often law enforcement authorities have little regard to financial inclusion measures being implemented by a financial institution when they are conducting investigations on a case where financial inclusion measures were applied;
iii. Difficulty of customer verification and the problem of improper address and postal system in most communities (rural settings, newly created urban townships, city slumps, etc.);
iv. Low level financial literacy among the general population;
v. Inadequate infrastructure resulting into high operational cost, which is largely responsible for high transaction charges;
vi. Large informal sector and the prevalence of cash leading to low savings, low market participation and less liquidity;
vii. Unhealthy competition among financial operators, especially due to the fact that the economic and financial space is small, with large holdings owned by governments; and
viii. Challenges related to emerging products and services developed with new technologies (regulation, supervision, risks, etc.).

SECTION 5

Emerging Good Practices and Challenges

Introduction

80. This section provides a summary of practices that were considered valuable and should be sustained and replicated. Also, obstacles that continue to hamper the effective realisation of the twin objectives of financial integrity and financial inclusion have been identified.

81. As mentioned earlier in the report, the financial inclusion products and services that have been making inroads in the region are digital and branchless banking solutions, with the use of local debit cards and Point-of-Sale (PoS); mobile money; and digital based local transfers. In addition to the digital and branchless banking solutions, there are non-digital solutions like microfinance (credit and savings); rural and community banking.

Emerging Good Practices

82. The use of local bank debit cards and PoS in Cabo Verde is a good practice worth replicating by other countries in the region. This practice is not only good for the promotion of financial inclusion but will also mop up cash in the economy, increase banks' lending capacity (through enhanced liquidity-cash ratio) and make audit trail seamless and easy.

Box5.1

The use of local banks' debit card and the presence of PoS in small and medium businesses in all corners of the Cabo Verdean islands, make debit card the leading financial inclusion product in the country. Unlike most West African countries where mobile money is taking the lead, local debit card has been an effective solution in Cabo Verde. The success is firstly, as a result of the simultaneous rollout with PoS. Cabo Verde is next to Nigeria in the region when it comes to PoS deployment. Secondly, all transactions below the 50 Euros threshold and its equivalence do not attract charges.

The switch provider and issuer of debit cards, SEPS, is collectively owned by all the major commercial banks in Cabo Verde - an arrangement which the Bank of Cabo Verde helps to facilitate the roll out.

83. Mobile money services exist in all of West Africa and have been growing steadily over the last five years, both in terms of subscription and rate of transactions. The service is mostly popular for transfers. Other payment services, particularly utility bills settlement, are also becoming popular. Yet, West Africa is trailing behind east Africa, where mobile services are more popular in Africa.

84. The methods used to rollout the product differ from country to country. While some countries are using the bank to lead in rollout of products and partnering with Telecoms to provide the platform, others are using Telecoms as lead, with the Telecoms holding an account in a bank. The accounts mirror the total value of deposit available for transactions.

Box5.2

Orange Money, a leading mobile money service provider in the WAEMU region, is the leading financial inclusion product in that region. Although there are other mobile money products in the WAEMU region, Orange Money dominates. In addition to transfers, which is done within and amongst its member States, it provides payment platform for in-country settlement of utility bills and purchases at retail stores registered with the provider. Orange Money is also present in some of the non-WAEMU member States of West Africa, including Guinea and Sierra Leone. Its main partner is the Ecobank, a bank with presence in the whole of West Africa and beyond.

Like the m-Pesa in Kenya, Orange Money has a great potential to bring more people in the formal financial realm. Other mobile money products are making similar breakthroughs in non-WAEMU countries. What is unique about the WAEMU region is, because of the common economic and monetary zone they are in, cross-border transfers using mobile money is allowed but very closely monitored.

85. There are other domestic transfer systems as well in the region. Some are bank-based, while others are digital solutions. Although there are various product models, below are two illustrations of products worth highlighting, one is with a banking solution and the other a digital solution.

Box5.3

Wari is a domestic / local transfer service based in Senegal and also operating in other parts of the region, particularly countries sharing borders with Senegal, including the Gambia, Guinea, Guinea Bissau, Mali and Mauritania. Wari is purely a money transfer solution and is very popular among the locals and attract minimal charges, but very convenient, as one can send or receive money in any of the local food / grocery stores in every corner of the country.

There are other services that provide similar platforms in Senegal, like Joni-Joni. However, Wari is the leading provider of that platform. Other member States have also rolled out similar products that are worth promoting and sustaining, because they promote financial inclusion in a large scale.

Box5.4

The Ecobank Rapid Transfer is a bank-based solution for domestic / local money transfer service operating in all countries of the region. The transfer is done locally and one can send and receive funds in any of the Ecobank branches within the country with no prior business relationship with the bank.

For transfer to other countries where Ecobank exists, with the exception of Nigeria, money can also be sent and received even without having any prior banking relationship with the bank.

To send money, all that is required is an ID and a transaction voucher with a code, which is sent to the receiver who then walk into the nearest Ecobank branch with an ID to pick up the money equivalent in local currency. Although there exist other banks in the region with similar products, they do not include cross border transfers.

86. Apart from the digital and branchless banking platforms that provide financial inclusion solutions, there are microfinance channels and the rural and community banking solutions that provide products and services targeting the underserved and unbanked communities in the region.

87. Microfinance institutions/agencies can take various forms. There are 3 types of microfinance institutions operating in the region. The typical microfinance institution that operates both savings and credit accounts for its customers; the non-governmental organisation (NGO) type that mostly operates as credit agencies; and those that are operated by sole proprietors and can operate like any of the two models mentioned above. Generally, the products offered by microfinance institutions are savings and/or credit. It is only in Ghana that micro-insurance has been introduced. However, it is still an experiment.

Box5.5

There are a few standard microfinance institutions with medium business capacity and they operate like a typical financial institution. They offer both savings and credit products to their clients. They are more formal in operations with full range of compliance functions and supervision.

The targeted client base of these institutions are mostly small businesses owned by sole proprietors and low income workers/peasant farmers. They are also involved in crowd lending to minimize default rate.

Notable institutions in the region are microcredit in the WAEMU region, Brac in Liberia and Sierra Leone, and Reliance in the Gambia, among others. Ecobank also has a microfinance window in some of the countries in the region.

88. The second type of microfinance institutions, the NGO type is also very popular in the region and they are mostly local. They are more of an NGO than a financial institution. Their targets are disadvantage groups and small cooperatives involved in small economic activities.

Box5.6

A typical NGO-like microfinance is MORABI in Cabo Verde. MORABI started as an NGO engaged in empowering women. They organized the women into small groups and cooperatives who are mostly involved in fish trading. In trying to empower the small groups, they partner with government agencies and development partners to raise funds and lend to their members.

Over the years, microfinance has become the main activity of MORABI and they have impacted on the lives of many families by giving them access to finance and growing their businesses.

89. The majority of microfinance businesses are operated by local sole proprietors who provide services to their communities. The target groups are also small business owners, self-employed and skilled service providers, farmers and peasant employees. This type of microfinance can be both formal and informal. However, even when they are licenced, they are hardly monitored or supervised. There is the need to design public policies to formalise and supervise this informal or semiformal type of microfinance businesses in the region.

90. Lastly, worth mentioning is the rural and community banks. The Central Banks, in partnership with donors, have put in place policies to expand financial services to the most remote areas in their jurisdictions. The rural banks provide banking services to the people in the communities they operate, particularly small farmers and businesses.

Box5.7

Rural and Community Banks have been very instrumental in giving financial access to deprived and disadvantaged communities. The IFAD project in most of West Africa, in partnership with member States' Central Banks, established an apex bank which helped to fund the creation of rural community banks in order to provide financial services to rural community dwellers and government officials working in these areas.

Notably, among the apex banks that provide supervision for these rural banks are those in Sierra Leone and Nigeria. The rural banks provide basic banking products for clients, including savings, loans, transfer, etc.

Key Challenges

91. As mentioned earlier in the report, there are a number of good practices as highlighted above. However, there are a number of challenges that continue to stand on the way of authorities, operators, development partners and other key stakeholders in expanding financial inclusion in the region. A key challenge relates to the lack of robust identification infrastructure in most of the countries in the region, particularly the smaller economies. Related to the challenge of identification is the issue of inappropriate or inadequate addressing systems and, lastly, the culture of non-disclosure on the part of clients as their profile changes.

Box5.8

A major challenge in getting access to finance is the fact that potential clients are not in possession of proper ID that is acceptable to financial institutions and recognized by the regulatory and supervisory authorities. Although some countries have adopted a tier system of classifying clients and accepting non-traditional or unofficial IDs with less security features, provided they are categorized as low risk clients. However, this practice has not addressed the fundamental problem.

The biggest challenge remains inadequate ID infrastructure in most member States that can provide the officially recognized IDs that are easily verifiable by financial operators. Access to such ID should be seamless and at limited and affordable cost.

The BVN innovation in Nigeria is worth replicating, all it throws of its on challenges such as the creation of multiple proxy accounts managed with different beneficial owners other than the person in whose name the account was opened, whether the proxy operates the account or not.

Box5.9

Another daunting challenge has to do with improper or the lack of addressing systems in majority of the communities in ECOWAS countries. This is more evident in new settlements in cities (the Gambia, Liberia and Sierra Leone); and rural communities and slumps in all the 15 countries of the region.

The lack of proper addressing system is making the process of KYC-CDD more daunting and costly for financial institutions and remains a major obstacle to financial inclusion. State authorities need to formulate policies and adopt measures that can facilitate the proper identification of the locations of settlements with appropriate addresses.

Ghana is currently working on a state-of-the-art, digital-based addressing system, which is planned to cover all communities. The system is similar to the post or zip code system, but is digital-based with a central management point that works like google map.

SECTION 6

Summary, Conclusion and Recommendations

Summary and Conclusion

92. In the context of revolutionary financial technology and rapidly growing access to financial services by the hitherto underserved, financial authorities within the region and all around the world are of the strong view that financial institutions need to ensure that they have adequate controls and procedures in place in order to know their customers and adequately monitor criminal financial activities. Adequacy of due diligence on new and existing customers is central to a KYC-CDD program. Inadequate due diligence, can expose financial institutions to reputational, operational, legal and concentration risks, which have huge financial and non-financial consequences.

93. The study highlighted a number of findings, including progress made by the financial sector at the policy level to revise legislations, carry out regulatory and supervisory reforms, and the improved level of compliance of the financial operators. The study also shows that financial inclusion is on a growth path with huge potentials for more growth. However, this trend has been undermined by a number of challenges, including the lack of flexibility in the identification and verification process, particularly when the KYC-CDD guidance is not explicit – when, how and who to be exempted from what. Other major challenges are on the ID infrastructure; and the inappropriate or inadequate addressing system or the lack of it.

94. The West African region has been very slow at adapting innovative policies and measures to advance financial inclusion compared to some regions of the world, especially South East Asia, Latin America and even east Africa. The findings of this study reinforced this assertion. The size of the region's population excluded from formal financial services remain worryingly high. More worrying is the fact that efforts made so far to deepen and widen financial inclusion tended to favour a few – the urban, educated people – a group that is easier to reach and will eventually enrol into the formal financial environment. There are many innovative products that can be adapted to meet the region's needs without re-inventing the wheel. The challenge remains with lack of sufficient political will and commitment and lack of clear and inclusive policies. The industry players appear willing to take a chance and innovate but the regulatory framework is weak and cannot support the fast changing pace of the innovation needed to make the required progress. On the other hand, some of the industry players are also not investing enough to develop the capacity of their personnel to meet the challenges of a financial inclusion-friendly compliance.

95. It is difficult to provide financial services to any group of people unless they can be properly identified and engaged. Where it is more difficult is when service providers are also waiting for the people to come forward to demand for the services instead of taking it to them. A middle road can be found where, supply seeks to create demand instead of relying on demand to create supply. The road ahead towards rapid progress in expanding financial inclusion in the region appears hazy, but the visibility can be significantly improved if the key actors can come together to re-strategize based on lessons learned. It is never late to adopt a new approach to financial inclusion in West Africa. In fact, **NOW** is the right time.

Recommendations

96. It is clear from the study that there is no coordinated regional approach to financial inclusion even though there various actions being implemented towards regional economic integration. This void needs to be filled by the ECOWAS Commission. Champions are needed and platforms should be built to allow the local champions to share with others what they have achieved. A sound and practical regional policy on financial inclusion need to be articulated and implemented religiously by all ECOWAS member States. Development partners should coordinate or be pressured to prioritise assistance for financial inclusion activities in the region. It is an emergency that should be well responded to by political leaders and partners.

97. In addition to regional political and policy actions, the following specific recommendations are made for consideration by national authorities, operators, development partners and other key stakeholders.

State Authorities

i. Develop or re-design national financial inclusion policies to take into account the roles of different stakeholders and prioritise financial literacy drive, as well as factoring risk based financial inclusion measures in order to provide operators the flexibility they need to promote financial inclusion;
ii. State authorities, in collaboration with concerned stakeholders, should establish a consolidated customer database for the purpose of identification and verification. The database should be made accessible to all financial operators. Such database should include biometric information with unique identification numbers such as the Bank Verification Number policy adopted and implemented by Nigeria;
iii. Consider the use of networks of financial institutions and other supervised entities as an entry level identification point for customers, while ensuring that risk mitigation for business relationships are put in place so that customers can build profiles for subsequent reference;
iv. Expand the list of reference and identity verifying entities to include government and non-governmental institutions of repute such as schools/colleges/universities, reputable religious organisations, respected traditional institutions, reputable companies, recognised hospitals, formally recognised associations such as professional bodies, unions of repute, reputable individuals, etc.
v. The cost of acquiring personal IDs should be subsidised, where possible, or be made payable over time through partnership with financial institutions and telecom companies;
vi. Countries should consider the possibility of involving private entities, particularly banks, in capturing data for national identification systems, while the data captured can be verified by appropriate competent authority before the ID is issued.
vii. State authorities should explore the possibility of linking all data capturing points – such as schools, hospitals, car licence, land registries, company registries, etc., and make it mandatory for some key nationally required data sets to be gathered through the process, which can then be organised as a database.

viii. Countries should consider broadening the range of optional documents and mechanisms that can qualify as ID for business relationships with financial service providers, e.g., voters card, social security cards, call-to-verify, etc., especially when it comes to low risk customers and transactions.

Regulators and Supervisors

i. Conduct risk assessments associated with the operations of the low intensive financial sub-sectors of the financial industry (micro-finance, mobile money, rural banking and proprietary exchange bureaux) in order to develop appropriate regulatory and supervisory framework that meet their circumstance.
ii. Strengthen collaboration and cooperation with industry operators in order to fully understand their concerns and work with them to develop a regulatory framework that works for all in the pursuit of a common objective of promoting financial integrity and inclusion.
iii. Provide adequate training and optimal resources to enable personnel to carry out their duties at per with the technological innovation in the industry.
iv. Create the space for the emergence of financial inclusion products that are outside the banking system in order to enhance competition and expand the reach of financial services in the general population.

Operators

i. Incorporate financial literacy programs in their corporate social responsibility deliveries.
ii. Incorporate financial inclusion in the professional development trainings of relevant staff.
iii. Create an industry coordination platform on financial inclusion in order to share experiences and to coordinate with government in support of its financial inclusion drive.
iv. Adequately invest in capacity building for staff to be able to implement risk-based compliance in a financial inclusion-friendly manner.

Regional institutions and Development partners

v. ECOWAS Commission should develop a regional policy on financial inclusion, in collaboration with member States, the private sector and other interested parties.
vi. GIABA should lead and facilitate the development of a model guideline and best practice paper on the implementation of the risk-based KYC-CDD measures in the context of financial inclusion for use by financial institutions in the region;
vii. GIABA, in collaboration with relevant stakeholders, should deepen its intervention by developing a special intervention program to facilitate the development of comprehensive national frameworks to guide operators on risk based compliance in the context of financial inclusion;
viii. The West African Monetary Institute, the West African Monetary Agency and the West African Bank for Development, in collaboration with partners such the World

Bank, IMF and AfDB, should create a platform for the integration of financial inclusion issues in the monetary integration drive.

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