Statement to the U.S. House of Representatives Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit
Hearing entitled "Examining De-risking and its Effect on Access to Financial Services"

Studies have shown that de-risking is negatively impacting financial inclusion.[1] In addition to account closures or the denial of new bank accounts, non-profit organizations are also reporting delays in transactions and/or requests for increased information that present significant challenges to the timeliness and effectiveness of their work.[2] The term de-risking itself is problematic, suggesting that the financial institutions are acting solely on the basis of risk when the drivers are actually more varied and complex. Perceived client risk and concern over rising anti-money laundering and countering the financing of terrorism (AML/CFT) fines and enforcement actions are an element of de-risking decisions, but other factors include low profitability of clients in the face of rising compliance costs, higher capital requirements and liquidity thresholds following the 2008 financial crisis, and reputational and liability concerns, among others.

At its core, de-risking is an instance of market failure:[3] all actors are behaving rationally, but the outcome is detrimental to society as a whole. The critical work of non-profit organizations and money service businesses (MSBs) has been constrained, especially those operating in conflict or humanitarian crisis zones. Entire economies are becoming increasingly isolated as correspondent banking relationships become scarce. These "unintended consequences" are especially impactful for socioeconomic and politically marginalized communities, especially women and women-led organizations.[4] While many have raised their voices to challenge de-risking practices, humanitarian and social-good based arguments have done little to influence the private sector to whom liability and profitability remain of utmost concern.

In instances of market failure, it is often the responsibility of the public sector to take actions that re-align market factors. While the public sector cannot dictate business practices of financial institutions, they do share a degree of responsibility in creating an operating environment that produces desirable results (or at least protects against negative impacts). This has historically come in the form of incentives for desired behaviors, legislation to oblige practices, and/or establishment of penalties or disincentives. Preventing and combatting the abuse of the financial system is a social good, which the public sector has promoted by issuing legislation and punitive actions for failures in AML/CFT practices. A growing body of evidence highlights the importance of financial inclusion on development indicators,[5] and international bodies such as the United Nations, G20, and

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[1] For example: "Report on the G20 Survey on De-Risking Activities in the Remittance Market," The World Bank Group, October 2015; "Withdrawal from Correspondent Banking: Where, Why, and What to Do About it," The World Bank Group, November 2015;
[2] Sue E. Eckert, "Financial Access for U.S. Nonprofits," Charity & Security Network, February 2017.
[3] Tracey Durner and Liat Shetret, "Understanding Bank De-Risking and its Impact on Financial Inclusion," Global Center on Cooperative Security, 2015.
[4] "Tightening the Purse Strings: What Countering Terrorism Financing Costs Gender Equality and Security," International Human Rights Clinic at Duke University School of Law and Women's Peacemakers Program, March 2017.
[5] Robert Cull, Tilman Ehrbeck, and Nina Holle, "Financial Inclusion and Development: Recent Impact Evidence," The Consultative Group to Assist the Poor, Focus Note No. 92, April 2014.

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the World Bank have identified expanded financial inclusion as a policy goal. Those who are seeking solutions to de-risking challenges view the importance of financial inclusion, alongside humanitarian and development objectives, as justification for public sector engagement to address de-risking challenges.

Many actors, including the U.S., have heeded this call by organizing stakeholder dialogues, evaluating policy, and issuing statements designed to advance risk-based approaches to AML/CFT. The Global Center on Cooperative Security applauds the U.S. for its ongoing commitment to address de-risking challenges. Numerous high-level officials and institutions haven identified de-risking as a core priority, and hearings such as this one continue to elevate the analytical discourse and bring critical attention to the issue. De-risking considerations and stakeholder consultations have informed revisions of the Bank Examiner's Manual, and in select instances bi-lateral and multi-lateral initiatives have been launched.[6]

While this represents positive progress, there is need for comprehensive responses that sustainably re-align market factors to alleviate de-risking tensions and promote expanded financial services. Based on our analysis and over ten years of work on financial inclusion issues, the Global Center on Cooperative Security offers the following recommendations to the U.S. House of Representatives on how it can influence and contribute to the re-adjustment of market factors to address de-risking challenges.

1. **Encourage Inter-Disciplinary Learning**: Disaster relief organizations have a wealth of experience in finding creative solutions to rapidly transfer funds to places where formal financial structures are inoperable. International refugee organizations have also developed innovative solutions to addressing customer identification challenges, which are a critical element of client AML/CFT risk assessments. Many such programs are supported by government development assistance, and thus come with requisite financial accountability and monitoring requirements from the implementing organizations –including U.S AML/CFT and sanctions obligations. While not without their own challenges, the experiences of these programs and organizations can provide insight on how financial services could be provided to sectors and communities experiencing de-risking challenges. Further research is needed to explore avenues of success and potential barriers to applying these interdisciplinary measures to de-risking environments.

2. **Provide Space for Exploratory Pilot Programs**: In select instances, the U.K. has offered "safer corridor" pilot programs and initiatives to facilitate remittance channels.[7] The U.K. Financial Conduct Authority has also created a regulatory "sandbox" initiative, which focuses on new technologies for better financial inclusion while mitigating risks, allowing firms to test innovative products, services, and business models in a live market environment, ensuring that appropriate regulatory safeguards are in place for all.[8] Such programs involve heavy engagement and dialogue between governments, financial service providers,

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[6] For example, the U.S. and Mexico worked together to amend Mexico's legal framework to facilitate necessary cross-border information sharing about clients' risks and established a domestic US dollar payment system that uses the Central Bank's corresponding banking relationship to facilitate transfers. (see: https://www.treasury.gov/press-center/press-releases/Pages/jl0608.aspx)

[7] Programs have been launched in Somalia and Pakistan. See: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/471064/UK-Somalia_Safer_Corridor_Initiative.pdf; and https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/471064/UK-Somalia_Safer_Corridor_Initiative.pdf

[88] See: https://www.fca.org.uk/publication/research-and-data/regulatory-sandbox-lessons-learned-report.pdf

technical experts, and regulatory authorities to both identify short-term solutions and work toward longer-term capacity and policy development that enables sustained financial channels. Given the reach of US financial regulation under the PATRIOT Act and the centrality of the US dollar to international financial transactions, similar programs from the U.S. would have far-reaching impact. While "safe harbor" programs are not viable or sustainable solutions, short-term and targeted pilot projects that incorporate learning and analysis components can help to identify evidence-based solutions, policies, and reforms that could help re-calibrate the de-risking landscape.

3. **Incentivize Niche Banking Services**: Assessing risk is a nuanced and context-specific endeavor, especially for clients operating in rapidly changing security or humanitarian crisis environments. Understanding and effectively managing risk for these clients requires a deep understanding of business practices and operating contexts, as well as consistent and responsive client management. Such practices are not always viable for larger-scale financial institutions, who tend to group clients into broad risk categories based on a set of pre-defined indicators and are unwilling or unable to incur additional compliance staffing costs for comparatively low-profit clients. Small and medium-scale financial institutions may be better positioned to develop niche banking services that cater specifically to sectors, geographies, or other categories of clients that are experiencing financial access challenges. The scale of business from these clients is more likely to be profitable to a smaller institution, but at present many are wary to engage over fears they will lose their correspondent banking relationships with large institutions or due to 'reputational dominos' where the client's loss of an account results in stigmatization. Incentivizing and fostering the development of niche banking services, paired with technical assistance to ensure banks can adequately manage AML/CFT risk, would allow smaller financial institutions to develop necessary expertise to handle these clients – including through fostering strong client-compliance officer relationships and necessary two-way dialogue on compliance obligations.

4. **Foster Enabling Environments for Technology Solutions**: Regulatory technology (RegTech) has rapidly become a burgeoning market that many financial institutions are looking toward to alleviate compliance challenges. Technological approaches vary, but examples include automated customer onboarding and monitoring, utilizing artificial intelligence and machine learning to identify suspicious transactions, big data analytics to support risk assessments and transaction monitoring, and centralized registries for customer due diligence (CDD) and know your customer (KYC) including through the use of blockchain technology, among others. Similar approaches to standardizing, streamlining, or centralizing compliance requirements have been undertaken in other sectors – including through the establishment of the Nationwide Mortgage Licensing System under the Housing and Economic Recovery Act of 2008. Regulators should foster ongoing and sustained dialogue with regulatory and financial technology companies and work to create enabling regulatory environments for the growth of these sectors.

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