

AML and the De-Risking Dilemma



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First published by ACQ (www.acq5.com)

In the global war to combat money laundering, the financial services industry appears to be nearing a dangerous tipping point. With criminal proceeds from money laundering estimated at between US\$590 billion and US\$1.5 trillion per year¹, Anti-Money Laundering (AML) has never been higher on the corporate agenda. The unprecedented amount of attention being paid to AML activities in boardrooms around the globe these days is due, in large part, to the increasingly harsh penalties being doled out to institutions deemed to run afoul of AML regulations – punishments that can include billion-dollar fines, banks being stripped of their operating licenses and threats of criminal prosecution against financial institutions and the executives who are paid to lead them.

The challenges related to AML and Know Your Customer (KYC) are no longer simply compliance issues. Rather, they impact virtually every aspect of the business, including operations, legal, risk and tax.

In response to the continuing crackdown on money laundering and terrorist financing, an increasing number of large financial institutions are opting to exit entire categories of customers. Indeed, with bank examinations becoming ever-more-granular and AML programs growing increasingly complex, whole segments of consumers and entire product lines are being abandoned by mainstream financial institutions.

This phenomenon is called 'de-risking'. In a bid to avoid the potential financial (and reputational) damage associated with non-compliance, a growing number of banks are choosing to de-risk entire portfolios and terminate relationships with clients in what are deemed to be 'high-risk' sectors, such as virtual currency operators, low-cost international money transfer services, faith-based charities and more. After surveying the regulatory landscape, weighing the relative pros and cons and making assessments with respect to risk and reward, these banks are deeming it safer to avoid high-risk clients altogether than to manage the associated compliance costs, technology upgrades and staffing

requirements that those high-risk relationships would necessitate.

From a purely practical perspective, it is not difficult to see the allure of de-risking as a business strategy. As Financial Action Task Force (FATF) President Roger Wilkins said, "It is sort of understandable that people working in banks find it easier to say 'no' rather than go through a process of understanding the intent and rules involved in a transaction. That of course is unless the customer is wealthy and the transaction is significant."

At the same time, there are those, however, who view de-risking is an overzealous reaction to increased regulatory oversight – a reaction that will translate into negative implications. For one, de-risking may lead banks to outlaw entire lawful industries, a move that could force some of these spurned entities and individuals to turn to the shadow banking system, creating potential systemic risks that could spread throughout the traditional banking system. Other victims of de-risking include vulnerable, low-income and rural populations, many of whom rely on money services business for their banking needs and who could find themselves without access to financial services.

Banks, for their part, continue to receive mixed messages. Some regulators are actively urging banks to stop the practice of de-risking. At the same time, however, it is clear that while banks can be punished for having the 'wrong' relationships, they cannot be punished for having no relationship at all.

While the goal of preventing or, at the very least, minimizing money laundering and terrorist financing is critically important, regulators must be attuned to the possibility that this growing de-risking backlash could end up creating more risk within the financial system. In order to help ensure the future health and security of the financial system, it will be imperative for all players to work together to identify the middle ground when it comes to AML and KYC.

1. Financial Transactions and Reports Analysis Centre of Canada.
<http://www.fintrac-canafe.gc.ca/fintrac-canafe/definitions/money-argent-eng.asp>