

September 11, 2020

Mr. Jose Manuel Campa  
Chairperson  
European Banking Authority  
EUROPLAZA  
20 Avenue André Prothin  
92400 Courbevoie France

**the  
Wolfsberg  
Group**



**RE: EBA call for input to understand the impact of de-risking on financial institutions and customers**

Dear Mr. Campa:

The Wolfsberg Group (“the Group”) and the Institute of International Finance (“IIF”) are grateful for the opportunity to respond to the European Banking Authority’s (“EBA”) call for input to understand the impact of de-risking on financial institutions (“FI”) and customers (the “Consultation”).<sup>1</sup> Our organizations strongly support the work of the EBA in leading, coordinating and monitoring the Anti-Money Laundering and Countering the Financing of Terrorism (“AML/CFT”) efforts of the European Union’s (“EU”) financial sector. Consultations like this, which help to understand better the drivers and effects of issues such as de-risking and the links with AML/CFT policy, are important undertakings and the financial services industry values playing a constructive role in the EBA’s analysis.

As such, our comments set out in the paper that follows are focused on two areas of the Consultation:

- 1. Background on the issues and drivers of de-risking; and*
- 2. Recommendations on measures for an effective AML/CFT framework that minimizes unintended consequences in order to mitigate structural de-risking trends.*

Our feedback is also directly linked to the wider AML/CFT reform efforts underway in the EU through the European Commission’s Action Plan for a comprehensive Union policy on preventing money laundering and terrorist financing (the “Action Plan”).<sup>2</sup> Along with understanding the drivers of de-risking, establishing an enhanced and effective system for financial crime risk management will assist in the creation of a more targeted framework for risk assessment. We believe this will help improve overall outcomes and assuage structural de-risking motivations.

We also note that the discussion around de-risking continues to be global in nature. The work of international standard setting bodies, including the Financial Action Task Force (“FATF”), the Financial Stability Board (“FSB”), the Basel Committee on Banking Supervision (“BCBS”) the Committee on Payments and Market Infrastructures (“CPMI”) and the Financial Stability Institute (“FSI”) should be carefully considered as the EBA continues its own work in this area. An internationally coordinated approach building on the effort to address the decline in correspondent banking should continue to be leveraged.<sup>3</sup>

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<sup>1</sup> EBA, *Call for input to understand the impact of de-risking on financial institutions and customers*, June 2020: <https://eba.europa.eu/eba-calls-input-understand-impact-de-risking-financial-institutions-and-customers>

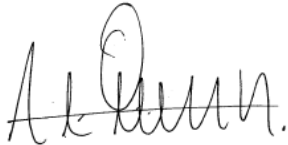
<sup>2</sup> Institute of International Finance, *Letter on EU AML/CFT Action Plan*, August 2020: <https://www.iif.com/Publications/ID/4055/IIF-Letter-on-EU-AMLCFT-Action-Plan>

<sup>3</sup> Please see the latest report from the CPMI on Correspondent Banking, August 2020: [https://www.bis.org/cpmi/paysysinfo/corr\\_bank\\_data/corr\\_bank\\_data\\_commentary\\_2008.htm](https://www.bis.org/cpmi/paysysinfo/corr_bank_data/corr_bank_data_commentary_2008.htm) and the report of the FSI, *Closing the loop: AML/CFT supervision of correspondent banking*, September 2020: <https://www.bis.org/fsi/publ/insights28.htm>

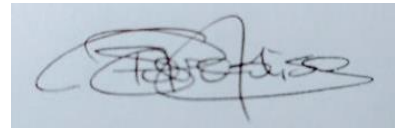
This will assist in advancing both the EU agenda and wider G20 goals on financial inclusion, economic growth, international trade and global development.

The Group and the IIF looks forward to working with you on these important issues. If we can be of further assistance, please contact us or the Wolfsberg Group Secretariat at [info@wolfsberg-principles.com](mailto:info@wolfsberg-principles.com) / Matthew Ekberg of the IIF at [mekberg@iif.com](mailto:mekberg@iif.com) .

Very truly yours,



Andres Portilla  
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## The Impact of De-risking on Financial Institutions and Customers - Key Issues and Recommendations:

### 1. Background on the issues and drivers of de-risking

The issues and drivers concerning de-risking are complex. To best understand the current environment, we believe it is important to address matters concerning the assessment of risk, structural effectiveness, information sharing, public/private sector cooperation and the cost of compliance holistically in terms of their concomitant impact on financial intermediation:

*First*, the FATF describes de-risking as

*'the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risk in line with the FATF's risk-based approach'.<sup>4</sup>*

Where an FI does not believe that it can effectively manage the financial crime risks associated with a business relationship, it should not enter into or maintain that business relationship. This is in line with legal obligations and international standards and it is therefore the correct outcome for individual customers to be exited or declined for this reason. However, wholesale termination or restriction of financial services can have a negative impact on access to banking and financial inclusion, competition, financial integration, and transparency. As such, FIs need to assess the risk of money laundering, terrorist financing and other financial crimes and apply proportionate risk mitigating measures; this is the cornerstone of FATF's risk-based approach.

In addition to AML/CFT risk management, it is important to acknowledge that FIs may exit or decline individual customers due to reputational considerations. Similarly, FIs can be presented with regulatory risk which may fall outside of the institution's risk appetite when legal obligations are either unclear or divergent across the jurisdictions in which they operate.

*Second*, previous analysis, such as the FSB's work on the decline of correspondent banking and the Centre for Global Development's ("CGD") 2015 recommendations and progress report,<sup>5</sup> has highlighted structural drivers to de-risking that the EU has an opportunity to address through the European Commission's Action Plan. Our collective feedback on the Action Plan focuses on the drive for effectiveness in the AML/CFT framework, a goal championed by our members and by the FATF.<sup>6</sup> The drive for effectiveness will also help address de-risking as an unintended consequence of the AML/CFT framework. We therefore recommend that the EBA consider de-risking as inherently interlinked with work to address systemic issues for the EU's AML/CFT framework outlined in the Action Plan and discussed in more detail in Section 2 of this paper.

*Third*, it has been extensively documented that information sharing can help FIs address risk more effectively and efficiently. For example, the CPMI has acknowledged that if banks in a correspondent banking relationship cannot provide additional information on customers and specific transactions due to legal and regulatory restrictions on information exchange, correspondent banks may have no alternative but to block or reject certain transactions. This may in some cases lead to the termination of some banking

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<sup>4</sup> FATF, *FATF clarifies risk-based approach: case-by-case, not wholesale de-risking*, October 2014

<sup>5</sup> Center for Global Development, *Policy Responses to De-risking: Progress Report on the CGD Working Group's 2015 Recommendations*, October 2018: <https://www.cgdev.org/reader/policy-responses-de-risking?page=0>

<sup>6</sup> FATF, *An effective system to combat money laundering and terrorist financing* :<https://www.fatf-gafi.org/publications/mutualevaluations/documents/effectiveness.html>

relationships and contribute to financial exclusion.<sup>7</sup> The absence of public/private sector cooperation and Public/Private Partnerships (“PPP”) can also contribute to an environment which inhibits targeted information-based risk analysis.

*Fourth*, we would argue that it is important to make a distinction between de-risking and the impact that the cost of compliance with the AML/CFT legal and regulatory framework has on the viability of business lines, where that cost exceeds the realistic value of the business.

As outlined in the Wolfsberg Group’s Statement on Effectiveness, ‘*FIs devote a significant amount of resources to practices designed to maximise technical compliance while not necessarily optimising the detection or deterrence of illicit activity*’. The Statement outlines that a focus by jurisdictions on adopting the FATF’s focus on effective outcomes will bring ‘*the benefit of reducing friction on customers and helping governments with their objective of financial inclusion*’. Effectiveness, the cost of compliance, ‘de-risking’ and transparency are therefore intrinsically linked.<sup>8</sup>

Relevant factors that drive excessive cost, and therefore result in unintended consequences linked to de-risking, include:

- Complex legal obligations and lack of harmonisation at international level (including across Member States, such as reporting beneficial ownership discrepancies to the central register held by each Member State).
- Legal and regulatory frameworks that drive a rules-based AML/CFT regime, as opposed to the risk-based approach promoted by the FATF. Rules-based elements of the AML/CFT regime impose a ‘one size fits all’ approach, resulting in disproportionate cost to maintain customer relationships in lower risk situations – one example being the application of additional mitigating measures on business relationships and transactions involving third countries identified by the European Commission as having strategic AML/CFT weaknesses.
- Costs are amplified when legal and regulatory requirements are unclear and supervisory activity focuses on whether rules are complied with from a technical perspective, rather than on the effectiveness of AML/CFT outcomes.
- AML/CFT regimes that result in FIs (and other regulated firms) managing risk introduced into the financial system by sectors that are not within scope of the regime.

## ***2. Recommendations on measures to drive an effective AML/CFT framework that minimises unintended consequences in order to mitigate de-risking trends.***

A combination of all the issues outlined in Section 1 of this letter can contribute to a complex environment for decisions on exiting business lines or relationships. However, steps can be taken to address some of these issues through structural ML/TF risk management reform. As such, we recommend that the EBA, the European Commission and the other relevant EU Institutions and Authorities consider the following measures to drive an effective AML/CFT framework that minimises unintended consequences which can lead to de-risking:

### **a. FIs and supervisors should support FATF’s statements on de-risking**

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<sup>7</sup> CPMI, *Correspondent Banking*, July 2016, pp. 27-28.

<sup>8</sup> Wolfsberg Group, *Statement on Effectiveness*: [https://www.wolfsberg-principles.com/sites/default/files/wb/pdfs/Effectiveness%201%20pager%20Wolfsberg%20Group%202019%20FINAL\\_Publication.pdf](https://www.wolfsberg-principles.com/sites/default/files/wb/pdfs/Effectiveness%201%20pager%20Wolfsberg%20Group%202019%20FINAL_Publication.pdf).

For further information on these effectiveness in the AML/CFT framework, please also see: IIF/Deloitte, *The Global Framework for Fighting Financial Crime: Enhancing Effectiveness and Improving Outcomes*, October 2019: <https://www.iif.com/Publications/ID/3606/The-Global-Framework-for-Fighting-Financial-Crime-Enhancing-Effectiveness-Improving-Outcomes>

We support the FATF's statement that *'what is not in line with the FATF standards is the wholesale cutting loose of entire classes of customer, without taking into account, seriously and comprehensively, their level of risk or risk mitigation measures for individual customers within a particular sector'*.<sup>9</sup> FIs must understand the money laundering and terrorist financing ("ML/TF") risk each customer poses through effective due diligence and risk assessment bolstered by domestic and cross-border information sharing. FIs should not terminate/restrict wholesale categories of customers in order to reduce or avoid ML/TF risk. We support supervisory authorities in considering wholesale de-risking as part of their supervisory activity, ensuring that FIs are managing (and not avoiding) risk. This recognises, however, that it is appropriate and prudent business practice to consider the cost of effective risk management when determining the viability of a product offering. This also recognises that exiting a relationship because an FI does not believe it can appropriately manage the risk or specific concerns about the activity have been identified in the course of the relationship is fully in line with AML/CFT objectives.

An example of good practice of FIs and other sectors working together to address de-risking is in the United Kingdom, where UK Finance, with input from payment service bodies, has issued good practice guidelines within the context of the Payment Services Regulations:

*'in order to encourage an improvement in market practice and provide a point of departure for other efforts to promote a transparent, effective and functioning market for both those applying for payment accounts and those providing access'*.<sup>10</sup>

By providing guidelines to both FIs and payment institutions, the document ensures that each party is informed of the expectations of the other.

**b. Identify and reduce the unintended consequences emanating from the legal and regulatory regime for financial crime risk management and compliance**

When developing a legal and regulatory regime for financial crime risk management and compliance, we encourage policy makers, regulators and supervisory bodies to undertake a rigorous assessment of the following:

- Effectiveness of the proposed measures in the fight against financial crime;
- The compliance costs to be incurred by the regulated sector, including opportunity costs for resource that may need to be redirected; and
- Unintended consequences, including adverse impact on legitimate business relationships and payment flows, which may result from implementation.

We recommend that the work of identifying and addressing these issues becomes a pillar in the formulation of new policy, law and guidance.

**c. Promote and strengthen the risk-based approach and focus on AML/CFT outcomes**

We welcome the suggestion in the European Commission's Action Plan that where third countries present strategic AML/CFT deficiencies:

*'an EU-level supervisor could also contribute to mitigating risks from third countries by developing appropriate risk mitigating measures for obliged entities depending on the type and severity of*

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<sup>9</sup> FATF clarifies risk-based approach: case-by-case, not wholesale de-risking: <http://www.fatf-gafi.org/documents/news/rba-and-de-risking.html>

<sup>10</sup> UK Finance: <https://www.ukfinance.org.uk/policy-and-guidance/reports-publications/access-to-payment-account-services>

*deficiencies. This would include developing more granular and risk-based measures to address risks posed by the AML/CFT framework of other jurisdictions’.*<sup>11</sup>

The provision of nuanced information on money laundering and terrorist financing risk will result in the private sector applying more informed customer risk assessments. In turn, this will improve decision making, ensure that enhanced measures are applied effectively, thereby minimising adverse consequences on legitimate business. Likewise, a focus on identifying lower risk factors and promotion of Simplified Due Diligence would strengthen the risk-based approach.

There are some good examples of the public and private sectors working together in partnership to produce more granular threat assessments. These threat assessments set out the collective understanding of the money laundering and terrorist financing risks in certain sectors, including those sectors traditionally labelled as high risk and therefore more likely to be de-risked. This approach can also assist the private sector to focus measures on the law enforcement priorities included in the assessments, resulting in better AML/CFT outcomes.

We encourage the EBA and the European Commission to consider FATF’s approach to the Non-Profit sector in FATF Recommendation 8 as an example of sound practice. In June 2016, FATF revised Recommendation 8 and its interpretive note, removing the assertion that NPOs are “*particularly vulnerable*” to terrorist financing. In doing so, the FATF recognised that “*NPOs provide a range of vital services in our society, in particular for vulnerable communities and often in high-risk regions*”. The revised Recommendation 8 directed countries to apply the risk-based approach to NPOs, which: a) moved away from a sector-wide generalisation to a more detailed assessment of the risk, and b) highlighted lower risk factors of the NPO sector to be considered by the regulated sector when assessing customer risk. The third country regime shares an aim of Recommendation 8, in that it should not adversely impact legitimate business; a similar promotion of the risk-based approach will therefore help deliver this objective.

#### **d. Reduce complexity through harmonisation of legal and regulatory requirements**

A lack of consistency in legal and regulatory requirements can lead to negative outcomes, these can be addressed by:

- i. *Harmonisation across Member States.* We welcome the Commission’s proposal to reinforce and develop the EU AML/CFT single rulebook through the targeted adoption of regulations. The issuance of a Regulation rather than a Directive has the potential to improve consistency, reduce complexity, and remove regulatory risks that act as barriers to doing business.
- ii. *Harmonisation with international standards.* We welcome the clarification in the 5<sup>th</sup> EU Money Laundering Directive that mandatory Enhanced Due Diligence on correspondent banking need only be applied when the relationship involves the execution of payments. This approach aligns with FATF’s guidance on correspondent banking published in October 2016<sup>12</sup>, which promoted the risk-based approach by stressing that not all correspondent banking relationships carry the same level of money laundering or terrorist financing risk and that enhanced due diligence measures have to be commensurate with the identified risk. Such clarifications require timely, effective, implementation by FIs, supported by harmonious

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<sup>11</sup> Action plan for a comprehensive Union policy on preventing money laundering and terrorism financing: [https://ec.europa.eu/info/publications/200507-anti-money-laundering-terrorism-financing-action-plan\\_en](https://ec.europa.eu/info/publications/200507-anti-money-laundering-terrorism-financing-action-plan_en)

<sup>12</sup> FATF, *Guidance on Correspondent Banking Services*, October 2016 <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-Correspondent-Banking-Services.pdf>

regulation and guidance, as well as by supervisors applying these principles in their examinations.

**e. Improve information sharing and public/private sector cooperation**

As the Group and the IIF have outlined in the past, proper management of risk in AML/CFT efforts can be improved by permitting and encouraging the better sharing of financial crime information, both domestically and internationally. Without adequate insights by banks, law enforcement, and intelligence agencies into the funding of these activities, efforts to stop criminals, terrorists, and rogue states from inflicting further damage globally will be increasingly inhibited in light of the growing sophistication of criminal schemes.

Information sharing and public/public sector cooperation can also lead to better and more targeted risk analysis and positively impact risk appetites when the whole threat landscape can be adequately assessed. As such, we believe AML/CFT rules in the EU should address challenges to operative sharing of AML/CFT information and also support public/private partnerships which improve the exchange of both strategic (typologies and geographic indicators, for example) and tactical (underlying case data) information. Coordination with countries outside the EU should also be prioritised in this area.

**f. Support capacity building in third countries that present strategic AML/CFT deficiencies**

The G20 countries, the FSB and International Monetary Fund (“IMF”) have all emphasised capacity building as an effective way to mitigate de-risking of international correspondent banking relationships. Capacity building directed toward helping governments improve their AML/CFT legal and regulatory frameworks, and related supervisory practices, is an important step to reducing financial crime risk. We welcome the European Commission’s approach in the context of third countries, whilst stressing the need to understand and assist mitigation of the specific financial crime threat. We recommend sharing this nuanced threat analysis with the regulated sector to facilitate the use of the risk-based approach in a way that drives targeted application of enhanced AML/CFT measures that minimises adverse impact on legitimate business.

**g. Strengthen supervision and develop an ecosystem approach to AML/CFT**

We encourage the EU to strengthen the supervisory framework for all regulated sectors that introduce risk to the financial system. For example, the 2019 EU Supranational Risk Assessment reported that the AML/CFT risk of Designated Non-Financial Businesses is ‘*very significant overall*’ and that ‘*in the large majority of Member States, supervision in these sectors still suffers from weaknesses in terms of controls.*’<sup>13</sup> The application by FIs of enhanced AML/CFT measures on domestic customers which are themselves regulated firms can duplicate supervisory activity. As such, robust and transparent supervision of these firms will help FIs to continue to provide services to these customers.

We support the European Central Bank’s (“ECB”) comment in its recent response to the European Commission’s public consultation on a new digital finance strategy for a Europe/FinTech action plan, which states that “*in the context of the current regulatory framework, different entities which could perform to a certain extent similar activities, such as credit institutions, e-money institutions and payment institutions, are subject to various regulatory and supervisory frameworks, either at national or European level. As this trend is accelerated by innovation and digitalisation, this framework may need to be reviewed to ensure a*

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<sup>13</sup>European Commission, *Supranational Risk Assessment*, July 2019: [https://ec.europa.eu/info/sites/info/files/supranational\\_risk\\_assessment\\_of\\_the\\_money\\_laundering\\_and\\_terrorist\\_financing\\_risks\\_affecting\\_the\\_union.pdf](https://ec.europa.eu/info/sites/info/files/supranational_risk_assessment_of_the_money_laundering_and_terrorist_financing_risks_affecting_the_union.pdf)

*level playing field and maintain the principle of “same activity, same risks, same supervision and regulation.”<sup>14</sup>*

Furthermore, for its assessment of effectiveness, the FATF adopted an approach focusing on a hierarchy of defined outcomes. At the highest level, the objective in implementing AML/CTF measures is that:

*“Financial systems and the broader economy are protected from the threats of money laundering and the financing of terrorism and proliferation, thereby strengthening financial sector integrity and contributing to safety and security.”<sup>15</sup>*

We recommend a comprehensive EU AML/CFT policy approach should focus both on the regulated sector and on other sectors that introduce money laundering and terrorist financing risk into the financial system. At present, the regulated sector often bears the cost of risk introduced by these other sectors.

#### **h. Promote adoption of the Wolfsberg Correspondent Banking Due Diligence Questionnaire (“CBDDQ”)**

The CBDDQ sets out an enhanced and reasonable standard for cross-border and/or other higher risk correspondent banking due diligence.<sup>16</sup> It is our view that the adoption of a standardised, reasonable CBDDQ should engender a less arduous, and thereby inherently less costly, due diligence process for correspondent banks, which should also allow for a standard which all FIs, and their supervisors, can work towards achieving. This should, in the end, support the creation of a well supervised and more harmonised regulatory standard in the correspondent banking space, with longer term positive effects on de-risking, access to finance, the development of trade and financial inclusion. The CBDDQ has been welcomed by BCBS, the CPMI, the FATF, and the FSB and is the most widely adopted industry standard for correspondent banking due diligence.

To further aid industry and supervisors in understanding and adopting this approach, the CBDDQ’s substantive accompanying capacity building materials are intended for use by public sector entities as they work with banks and countries looking to enhance their own financial crime compliance programmes, as well as for banks and other FIs for their own training needs.<sup>17</sup>

#### **i. Support the use of KYC Utilities**

There continues to be growing use of third-party databases (or “KYC utilities”) in obtaining customer information. KYC utilities have considerable promise. For instance, FIs are highly interested in the potential of such utilities to increase efficiency for both correspondent and respondent banks as they gather and provide information, not only at account opening but also during the course of the relationship. They also have potential beyond just due diligence information. However, FIs also must be realistic about confronting the hurdles to effective reliance upon them. Cross-border restrictions on data transfer, storage, and usage are often hard to interpret but clearly make some vital information unavailable to certain entities under many circumstances, even to entities within the same group.

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<sup>14</sup>ECB, *ESCB/European banking supervision response to the European Commission’s public consultation on a new digital finance strategy for Europe/FinTech action plan*, August 2020: <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.esbceuropeanbankingsupervisionresponsetoeuropeancommissionpublicconsultationdigitalfinancestrategyeuropelifintechactionplan2020~b2e6cd0dc4.en.pdf>

<sup>15</sup> FATF, *An effective system to combat money laundering and terrorist financing* :<https://www.fatf-gafi.org/publications/mutualevaluations/documents/effectiveness.html>

<sup>16</sup> The Wolfsberg Group Correspondent Banking Due Diligence Questionnaire (CBDDQ): <https://wolfsberg-principles.com/wolfsbergcb>

<sup>17</sup> CBDDQ Capacity Building Materials: <https://wolfsberg-principles.com/cbddq-capacity-building-materials>



We believe information sharing barriers which impede the effectiveness of centralised KYC utilities - or any lack of a regulatory ability to rely on the information in the utility - should be reevaluated at both the EU level in concert with third country counterparts (and such work could be centralised through FATF and other relevant bodies including the BCBS and the CPMI).

**j. Support innovation**

As outlined in previous papers by our organisations on the subject, the financial crime risk management space is one that can benefit from advancements in financial technology solutions. From machine learning and data analytics to digital identity, it is clear that the potential to change the day-to-day approach to these matters is significant – thereby increasing effectiveness and efficiency in the system which can help mitigate some of the structural drivers of de-risking.

There is also a clear role for the public sector to play in encouraging the process for innovation in financial regulatory technology that assists in compliance with AML/CFT regulations. The regulatory environment must keep pace with technological change; this will help move from the current structure of AML/CFT compliance to a more dynamic intelligence-led financial crime risk management model.

For example, we welcome supervisory authorities hosting and facilitating innovation in financial services, such as the Monetary Authority of Singapore’s (“MAS”) FinTech Regulatory Sandbox and the UK Financial Conduct Authority’s Tech Sprint programme. A supervisory approach such as this at the EU level which encourages innovation – alongside a legislative framework that supports adoption through progressive policies - are essential enablers for innovation.

**Conclusion:**

We hope that you find the information we have provided regarding the drivers of de-risking and recommendations on measures to drive an effective AML/CFT framework that mitigates structural de-risking trends useful. Please do not hesitate to contact us as we remain at your disposal for any further clarification.