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Dear AUSTRAC,

Financial services for customers that financial institutions assess to be higher risk [H1] – draft guidance

Thank you for this opportunity to make a brief, focused submission regarding the draft guidance.

1 I am a law academic specialising in regulatory responses to international financial crime. I have undertaken various university research engagements with bodies such as the World Bank and I have worked closely with the World Bank-housed Consultative Group to Assist the Poor (CGAP) and with the Financial Integrity Working Group of the Alliance for Financial Inclusion (AFI). This work extended to a range of countries including Ghana, Indonesia, Jordan, Kenya, Kyrgyzstan, Malaysia, Namibia, Nigeria, Uganda, the Ukraine, Samoa and Palau. My research has been cited in publications and research papers of international bodies such as the World Bank, the Basel Committee on Banking Supervision, the International Labour Organisation, the G20's Global Partnership for Financial Inclusion and the World Economic Forum. I was invited to serve on the Financial Action Task Force (FATF) project group to draft its financial inclusion guidance in 2011 and to revise it in 2013 and 2017 and also contributed to its virtual asset service provider standards and guidance as well as its 2020 digital identity guidance.

2 I first studied large-scale, risk-informed denial of banking services in 2008 as a case study focused on the United States of America.[1] In 2014-15 I was a member of an international working group looking at de-banking and its impact on the poor.[2] In 2015-16 I was part of a group of researchers studying the denial of services to Australian remitters serving the

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1 Hennie Bester, Doubell Chamberlain, Louis de Koker, Christine Hougaard, Ryan Short, Anja Smith, and Richard Walker, *Implementing FATF Standards in Developing Countries and Financial Inclusion: Findings and Guidelines,* The FIRST Initiative, World Bank, Washington, DC (May 2008) at https://dro.deakin.edu.au/articles/book/Implementing_FATF_standards_in_developing_countries_and_financial_inclusion_findings_and_guidelines/21058708.

2 Collin, Matthew, Louis de Koker, Matthew Juden, Joseph Myers, Vijaya Ramachandran, Amit Sharma, and Gaiv Tata *Unintended Consequences of Anti–Money Laundering Policies for Poor Countries*, Center for Global Development, Washington, DC (2015).

Horn of Africa.[3] I led the drafting of the de-risking discussion in a white paper issued by the G20 Global Partnership for Financial Inclusion.[4]

3 I organised and co-organised and chaired workshops and panels on de-risking, for example from 2015 at the annual *Cambridge Annual Symposium on Economic Crime* where we enable representatives of global banks, governments, law enforcement and affected businesses to debate these denials of service and appropriate solutions. I also co-organised and/or chaired de-risking panel discussions at conferences for example in Basel (at the Bank for International Settlements) and Vienna (at the United Nations for the FATF and FSB) that facilitated engagement among global standard-setters and stakeholders.

4 I am currently engaged in de-risking research for the Asian Development Bank and for the OECD. In 2021 I was an expert witness *in Flynn v Westpac Banking Corporation* ACN 007 457 141 (Discrimination) [2022] ACAT 21 that enabled a closer examination of de-risking practices in Australia. The 2016 Australia remittance study referenced above also enabled me to record actual experiences of Australian businesses impacted by de-risking as well as Australian banking practices.

5 Drawing on my experiences with de-risking and de-banking since 2008 I want to commend AUSTRAC for its public de-banking statement in October 2021 and its draft non-binding guidance. The first such public statement was made in the US agencies in 2005 and FATF's later de-risking statements closely echoed the 2005 sentiments. While statements and non-binding guidance are appreciated they have, however, not proved particularly effective in curbing de-risking practices. During an October 2022 seminar at Cambridge, for example, the participants could not identify any re-banking of de-banked remittance customers by the institution that initially de-banked them.

6 De-risking practices should be of interest to AML/CTF/CPF supervisors as they point to limits or weaknesses in risk management practices and systems of regulated institutions. Most supervisors have however been sanguine about de-risking, often accepting and at least passively endorsing statements by that banks that they lacked the compliance capacity to serve certain sectors, or at least to serve them profitably, while they were

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3 Louis de Koker, Supriya Singh and Jonathan Capal, 'Closure of Bank Accounts of Remittance Service Providers: Global Challenges and Community Perspectives in Australia', *University of Queensland Law Journal*, 36 (2017), 119 at http://www.austlii.edu.au/au/journals/UQLawJl/2017/6.pdf.

4 Global Partnership for Financial Inclusion 'Global Standard-Setting Bodies and Financial Inclusion: The Evolving Landscape' (2016) at https://www.gpfi.org/publications/global-standard-setting-bodies-and-financial-inclusion-evolving-landscape.

banking casinos, oligarchs and known criminals. Those statements have rarely been scrutinised and publicly challenged by supervisors. Where supervisors undertake to review de-risking rationales (as is done here on page 14) there needs to be some clear standards that are applied to consider the quality of the rationale, and clarity about what the supervisor will do if it finds the rationale lacking.

7 If AUSTRAC wishes to curb unnecessary and discriminatory de-risking practices, it will need to be more precise about its minimum quality indicators for institutional risk assessment practices, risk appetite assessments and statements as well as compliance cost assessments. This is also required to make the review of de-risking rationales (p 14) meaningful. As mentioned above, without objective quality criteria, how would these be reviewed?

Quality indicators for risk assessment practices

8 Many supervisors fail to communicate a clear understanding of what an objective and sound risk assessment should entail. They often specify the building blocks of risk assessments and criteria to be considered and even risk levels but not how they should be considered and assessed, i.e. how the dots should be connected. Precise standards are not required but a subjective linking of dots or arbitrary linking of dots should not pass muster. The lack of standards sets the stage for arbitrary outcomes. In 2020 the US Office of the Comptroller of the Currency (OCC) proposed for comment a new rule requiring large banks to provide fair access to their services, stating: [5]

> Despite the OCC's statements and guidance over the years about the importance of assessing and managing risk on an individual customer basis, some banks continue to employ category-based risk evaluations to deny customers access to financial services. This happens even when an individual customer would qualify for the financial service if evaluated under an **objective, quantifiable risk-based analysis**. (own emphasis)

9 Having had access bank risk assessments that informed de-risking decisions I was struck by the lack of objective, quantifiable risk analysis. It is not clear how the factors that were considered were selected and, once selected, led to the conclusions, especially when viewed against the broader risks or risk mitigation measures of the institution. These processes must be improved, and improved consistently across the institution's customers, products, channels, etc. Australian supervisors have not called out subjective, flimsy and inconsistent ML/TF/PF risk assessments in the past in ways that led to consistent bank industry improvement. That will need to change if supervisors want to

[5] Office of the Comptroller of the Currency, 'Fair Access to Financial Services' RIN 1557-AF05 (2020) at https://www.occ.treas.gov/news-issuances/federal-register/2020/nr-occ-2020-156a.pdf 4-5.

see improved risk assessments that support AML/CTF policy objectives while preventing unintended consequences such as de-banking.

10 It would therefore be crucial to determine some minimum quality indicators that should be present in a risk assessment that informs de-risking decisions. These, I submit, should include process and outcome objectiveness, institution-wide consistency and application of quantifiable analysis, suitable to the size and capacity of the institution.

Quality indicators for risk appetite

11 Where de-risking outcomes were criticised institutions often countered by stating that the customer sector was beyond the institution's risk appetite. Supervisors often accepted that bland statement without attempting to understand why the same institution would have the appetite to serve sometimes very colourful customers.

12 Supervisors should not allow "risk appetite" to be abused to hide weak risk assessments or discrimination. In order to be more precise, supervisors should require an institution to justify its risk appetite decisions where the institution advances that as a reason for de-banking. That justification should also include a clear and objective definition of the institution's risk appetite, its risk appetite metrics and evidence of consistent application of those metrics across all its customer segments, channels and products, where applicable.

13 Such information will enable AUSTRAC to review the risk appetite decision objectively.

Quality indicators for compliance cost assessments

14 Where de-risking decisions were criticised institutions often countered by stating that the cost of risk control measures that were required rendered the relationship unprofitable. Where that argument is advanced the supervisor should require the institution to produce its risk control cost assessment and its calculations to apportion costs of its total control system to the particular customer or segment.

15 This information will enable AUSTRAC to review the cost decision objectively.

Review of rationale: Consequences

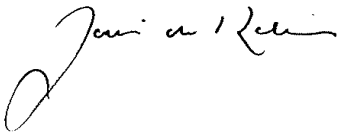
16 I recorded one case of a prominent fintech company that received a letter from its banker that the company's account would be closed. When following it up with the bank the CEO of the fintech company learnt that the decision was a sector-wide de-risking decision. The fintech CEO phoned the CEO of the bank, an old friend. The de-risking decision was reversed that same day, but only for that fintech company.

This is just one example of inconsistent and arbitrary banking decisions that have received a free supervisory pass in the past. This can change if AUSTRAC sets basic objective criteria that it would apply in the future to review de-risking decisions. It is however important that AUSTRAC also goes beyond merely reviewing de-risking rationales (p 14). What will AUSTRAC do if it finds that a decision was not justified? The document appears silent on that front. Unless AUSTRAC is prepared to intervene where decisions were not justified and communicates that in the guidance, the new guidance is unlikely to lead to improvements in the current processes.

While AUSTRAC cannot reverse institutional decisions, it can, for example, communicate that any concerns that it may have after its review of the rationale may lead to a comprehensive review of the quality of an institution's AML/CFT/CPF risk assessment and risk mitigation measures as a whole. A weak rationale should be viewed as red flag of further risk management weaknesses in the institution's systems. AUSTRAC can of course elect to do more, but remaining silent about what may follow a review but undermine the impact of the non-binding guidance.

I enclose the text of the draft guidance with some comments.

Yours sincerely,



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