

# Understanding Bank De-risking and its Effects on Financial Inclusion

## Exploratory Study

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### BACKGROUND

The World Bank estimates that half of the world's population lacks access to a formal bank account, and that the vast majority of financially excluded people live in developing countries.<sup>1</sup> Rural, low income, and other underrepresented groups such as women and youth tend to be disproportionately affected by financial exclusion, which reduces the ability of individuals and organizations to mitigate economic shocks, establish savings, develop businesses, and prepare investment plans.

Over the past decade, financial institutions have seen heightened levels of regulatory attention on their anti-money laundering and countering the financing of terrorism (AML/CFT) frameworks. With this increased scrutiny comes high penalties and threats of individual prosecutions for noncompliance. While some banking institutions have responded by strengthening oversight and communicating obligations to customers, some are opting to end relationships with clients deemed “high risk”—especially when the relationships pose more risk than potential returns.

A global trend has emerged whereby banks are closing accounts deemed high risk, which are often those of nongovernmental organizations, foreign embassies, correspondent banks, and money transfer businesses. This practice, referred to as de-risking, is perhaps an inevitable response from the financial services industry given the ascendance of AML/CFT in recent years, coupled with the 2008 financial crisis, which prompted the sector to rethink the way it defines and manages risk. However, there remains ambiguity around the criteria for de-risking actions and a lack of uniformity in its implementation across institutions. De-risking also presents challenges for financial inclusion goals, further limiting access to formal bank accounts for potential customers who may not meet requirements because they lack a previous banking history, and money transfer operators who cannot operate without a centralized account to temporarily hold funds.

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<sup>1</sup> World Bank Group, “Financial Inclusion Data World Bank,” <http://datatopics.worldbank.org/financialinclusion/>.

With the risk appetite declining in large financial institutions, it is possible that customers deemed high risk will seek accounts with medium-sized and smaller banks. However, these smaller financial institutions may lack the capacity to conduct effective AML/CFT compliance practices. AML/CFT measures are necessary to protect the stability of the international financial system and to cut off resources to violent extremist groups, but they have to be implemented with care in order to not exacerbate financial exclusion.

As banks de-risk, national governments are forced to make their own AML/CFT systems more robust to address these issues, but this may not always be suited to address sector- or institution-based needs. In principle this should serve to benefit a country's financial health but in practice it can block the development and growth of innovative mechanisms for the financial inclusion of marginalized groups.

### **ABOUT THIS PROJECT**

In November 2014 the Global Center on Cooperative Security started an exploratory study on this recent trend of de-risking in the financial services industry. The purpose of the study is to identify how the ascendance of AML/CFT law and policy has impacted bank de-risking practices and in turn access to financial services, particularly for vulnerable populations such as women, youth, and other marginalized communities.

The study will provide a detailed and nuanced presentation of the extent to which de-risking is occurring, the driving factors and influences behind it, and the potential impact on vulnerable institutions and populations. The study will analyze the banking-sector narrative, including reputational concerns and money laundering and terrorist financing risks, as well as identify the interests and decision-making processes for other key stakeholders including money transfer businesses, governments, and international organizations.

To achieve these objectives, the team will conduct desk research and analysis as well as conduct a series of interviews and roundtable discussions with representatives from private sector financial institutions, bankers' associations, nongovernmental organizations, money service businesses, government regulators, international financial institutions, AML/CFT oriented bodies, and civil society actors. Insights from this phase will contribute to a series of policy recommendations to governments, international AML/CFT standard setting bodies, and the private sector. This research and the ensuing recommendations will inform the development of a broader advocacy initiative from Oxfam America ([www.oxfamamerica.org](http://www.oxfamamerica.org)), which is partnering with the Global Center on this research study, to ensure that AML/CFT agendas do not result in the unintended financial exclusion of marginalized communities or the nonprofit sector.

### **ABOUT THE GLOBAL CENTER ON COOPERATIVE SECURITY**

The Global Center on Cooperative Security works with governments, international organizations, and civil society to develop and implement comprehensive and sustainable responses to complex international security challenges through collaborative policy research, context-sensitive programming, and capacity development. In cooperation with a global network of expert practitioners and partner organizations, the Global Center fosters stronger multilateral partnerships and convenes key stakeholders to support integrated and inclusive security policies across national, regional, and global actors.

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