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## Consultation Response

### AML/CFT and Financial Inclusion – proposed changes to FATF Standards

December 2024

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The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the Financial Action Task Force (FATF) consultation on AML/CFT and Financial Inclusion. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate for stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA), a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

We summarise below our high-level response to the consultation, which is followed by answers to the individual questions raised.

#### Executive Summary

We welcome FATF's intention to better align its Recommendations with measures to promote financial inclusion. We broadly support the suggested changes. We note however that certain issues are nuanced and need to be carefully considered.

We note that the stated purpose of the proposed changes is to address unintended consequences of AML/CFT measures. As the FATF seeks to make improvements, we suggest that care be taken to limit the potential for other unintended consequences to arise.

We are grateful to the FATF for opening the consultation. We consider that effective governance includes active industry outreach, engagement, and consultation – both before and after changes, as well as periodically. This approach ensures proportionality and supports the appropriate evolution of requirements and guidance.

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#### AFME general comments on FATF proposals

##### *Identification of targeted population*

We welcome and encourage the intention to promote financial inclusion. It is unclear however whether the implied excluded population is thought to be composed of natural or legal persons. Financial inclusion is a worthy goal to pursue, but the appropriate measures to take for a homeless or for an otherwise vulnerable individual will differ markedly from those taken for a small or medium sized enterprise, an NGO, or a corporate. It may be helpful for FATF to reflect on the intended population it seeks to assist, and to tailor its

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solutions and textual changes to the needs of that population. It may also be helpful to develop a clear definition of financial inclusion, the better to ensure a shared understanding amongst stakeholders.

#### *Need to avoid conflation of simplified due diligence with financial inclusion*

We are concerned by the implied conflation of simplified due diligence with financial inclusion.

Financial institutions sometimes offer – and some jurisdictions require – bespoke products for particular classes of vulnerable persons. Certain jurisdictions for example require banks to offer bank accounts for those without a fixed address, or for those formerly convicted of crimes. Such persons deserve access to financial products and services to permit their access to and inclusion within the supervised financial system. But their vulnerability does not necessarily mean that they are low risk, or that simplified due diligence should be applied.

It is right that they – and other such classes of vulnerable persons – have access to financial services, and that financial institutions should be required to assist them in a tailored and inclusive manner. But financial inclusion does not automatically mean low (or lower) risk, and we recommend avoiding any conflation which could suggest otherwise.

#### *Simplified due diligence as step toward financial inclusion; additional actions from regulators*

Simplified due diligence should therefore be considered as a step toward achieving financial inclusion, and not as the achievement of financial inclusion *per se*. The final achievement of financial inclusion will require close collaboration between financial institutions and competent authorities, with a clear signal from authorities to institutions to permit them to provide banking services to vulnerable persons via guided or assured measures that are distinct from those required as part of customer due diligence.

For this reason, we would welcome the FATF

- increasing its focus on encouragement (including formal regulatory assurance) provided by regulators and supervisors to support the appropriate application of simplified due diligence across wholesale financial services, to enhance the risk-based approach, and to support financial inclusion, and
- recognising that such encouragement and assurance could be provided via other measures beyond those focusing on customer due diligence, which should also be understood as ‘*appropriate*’ measures.

#### *Need to discourage jurisdictions exceeding common FATF standards*

We welcome FATF’s work to increase the international effectiveness of its measures. In addition to work on promoting international best practice and what has been proven to work well, we would welcome the FATF also seeking to discourage what does not work well. This would be particularly welcome where jurisdictions seek to increase requirements far in excess of agreed FATF standards.

Such attempts are sometimes portrayed as conservatism, or of erring on the side of caution. In some instances, this may be the case. In many instances however, it is not. When (for example) jurisdictions move away from the risk-based approach to require uniform, non-targeted or disproportionate activity, relevant authorities seeking to reduce risk may in fact inadvertently increase it.

Resources are finite, and requiring low-value activity to be performed with little benefit reduces the ability of organisations to appropriately focus resource on high-value activity, the better to reduce harm. If the FATF were to target such unhelpful activity and encourage authorities to adhere to jointly agreed standards, it would improve outcomes for consumers, markets, firms, and wider society.

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## **AFME comments on specific FATF proposals**

### **Proposal to replace the term '*commensurate*' with '*proportionate*' in Recommendation 1**

We support this proposal.

We consider that use of the previous term '*commensurate*' suggests measures that are more linear, that more closely track the risk described in a pre-determined manner, and as such, that allow less flexibility for risk managers and institutions to tailor the measures they take than the proposed alternative. Conversely, we consider that use of the term '*proportionate*' to be better aligned with the risk-based approach and more likely to allow risk managers and institutions to take a broader and more holistic approach to assessing and responding to the risks they face.

We note the definition of a proportionate or commensurate measure as one that '*appropriately corresponds to the level of identified risk and effectively mitigates the risks.*' However, we are concerned that the term '*effectively*' could be interpreted by some stakeholders as implying that institutions must aim for zero residual risk.

While we acknowledge and support the FATF's focus on the effectiveness of anti-financial crime regimes globally, we believe it is impractical for supervisors to expect institutions to achieve the complete elimination of risk. To avoid potential misinterpretation, it may be helpful for the FATF to clarify that institutions are expected to take reasonable steps to mitigate risks but are not required to eliminate them entirely.

### **Proposal to require supervisors to review and take into account the risk mitigation measures undertaken by financial institutions/DNFBPs**

We support this proposal.

We consider that effective supervisory authorities already take into account the risk mitigation measures undertaken by the entities they supervise. We consider that further encouragement in this direction may help the few remaining authorities which do not (or which currently do so only to a limited extent) to embrace better practice.

We note the reference made to '*national or sub-national risk assessments*' as a possible vehicle for authorities to use to identify areas of lower risk and to support financial institutions and DNFBPs to apply measures proportionate to those lower risks. We recognize that national or sub-national risk assessments have their place amongst the options available to authorities seeking to communicate with stakeholders. We also note however the ever-evolving nature of the financial crime landscape, which can often mean that a (sub-) national risk assessment's findings and overarching conclusions become outdated before a subsequent update is commissioned. We suggest that the sentence could work without mention of such risk assessments, or if

mention is to be made, then the sentence could also include reference to other such tools to avoid any possible suggestion that such static risk assessments should be privileged above other possibilities.

### **Proposal to recognize levels of due diligence as part of a spectrum of options for financial institutions/DNFBPs**

We support the principle that financial institutions and DNFBPs should differentiate the extent of due diligence measures they undertake, depending on the type and level of risk posed by a client, transaction, or situation. We would underline however that standard customer due diligence measures may also at times be an appropriate response, and not – as the proposed changes may inadvertently suggest – enhanced or simplified measures only. We therefore suggest to further amend paragraph 13 of the Interpretive Note to Recommendation 1 to read as follows (suggested addition in green):

***Risk management and mitigation** – Financial institutions and DNFBPs should be required to have policies, controls and procedures that enable them to manage and mitigate effectively the risks that have been identified (either by the country or by the financial institution or DNFBP). They should be required to monitor the implementation of those policies, controls and procedures, and apply standard, enhanced or simplified measures in line with the risks ~~to enhance them, if necessary~~. The policies, controls and procedures should be approved by senior management, and the measures taken to manage and mitigate the risks (whether higher or lower) should be proportionate to the risks as identified and consistent with national requirements and with guidance from competent authorities and SRBs.*

It may be beneficial for corporate and investment banks if the FATF acknowledges that simplified due diligence (SDD) can take various forms depending on the context. For instance, in some scenarios, SDD might involve simplified know your customer (KYC) procedures for the management and/or owners of a well-established corporate client, while simultaneously applying enhanced due diligence (EDD), such as human intelligence inquiries, to assess the client's business operations and practices.

In such cases, simplified KYC and EDD should not be viewed as contradictory. This nuanced approach to KYC and due diligence can be particularly valuable in jurisdictions where companies are sensitive to requests for managers' or owners' passports, but alternative methods of positively identifying key individuals are feasible. This flexibility – allowing for a tailored approach – could support financial inclusion, especially in higher-risk countries or regions with distinct cultural norms.

### **Proposal to replace 'countries may decide to allow simplified measures' with 'countries should allow and encourage simplified measures'**

We support this proposal.

In keeping with our earlier response, we consider that effective supervisory authorities already permit simplified due diligence measures to be used to allow resources to be focused efficiently on the most significant sources of risk. Again, for the few authorities that may be usefully encouraged to permit this approach, we consider that the proposed change is likely to prove helpful.

Simplified due diligence should however be used by firms as part of a careful and considered risk-based approach, and should be monitored by equally careful and considered risk-based supervision. Consistent

support from policymakers and supervisors, and clear guidance, is a key enabler to realise the objective of the proposed changes, and to fulfil the potential of proportionality and the risk-based approach.

**Proposal to follow ‘*non-face-to-face customer-identification and transactions*’ with the qualification ‘*unless appropriate risk mitigation measures have been implemented*’**

We support the broad intention of this proposal. We draw attention however to certain nuances that should be carefully considered before finalising this proposal.

We recognise that non-face-to-face customer identification and transactions are increasingly common practice and should not in all circumstances be automatically considered high risk.

We note however that non-face-to-face customer identification and transactions still pose risks beyond those present in face-to-face interaction.

Artificial intelligence capabilities are evolving rapidly, and currently at perhaps a greater pace than common understanding of them. The ability of artificial intelligence to make use of visual or voice impersonation or other forms of spoofing tools is already highly developed. It is not clear however that awareness of such impersonation possibilities is equally developed. Artificial intelligence can of course be used also to defend against such threats – but the threats remain.

We judge that the proposed amendment – to leave the mention of non-face-to-face customer-identification and transactions as an example of a circumstance that is inherently higher risk, and to qualify it with a following statement – is broadly correct.

We consider however that the proposed use of the word ‘*unless*’ could lead readers to believe that the risk would or could be reduced to a level where it would no longer be considered high, if the suggested ‘*appropriate*’ risk mitigation measures were implemented.

Given current technological capabilities and only nascent general understanding of the risks artificial intelligence-based spoofing technologies pose, we do not think this is correct.

We suggest therefore to amend the qualification by avoiding use of the proposed ‘*unless*’ and inserting a softer qualification based on the sense of the word ‘*although*’.

The bullet could therefore read

*non-face-to-face customer-identification and transactions – ~~unless appropriate risk mitigation measures have been implemented~~ – although implementation of appropriate risk mitigation measures could reduce the risk these pose.*

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We would welcome the opportunity to discuss any point made in this paper with FATF colleagues if helpful and we look forward to supporting you in your work.

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