Illicit financial flows and the risk-based approach (RBA)

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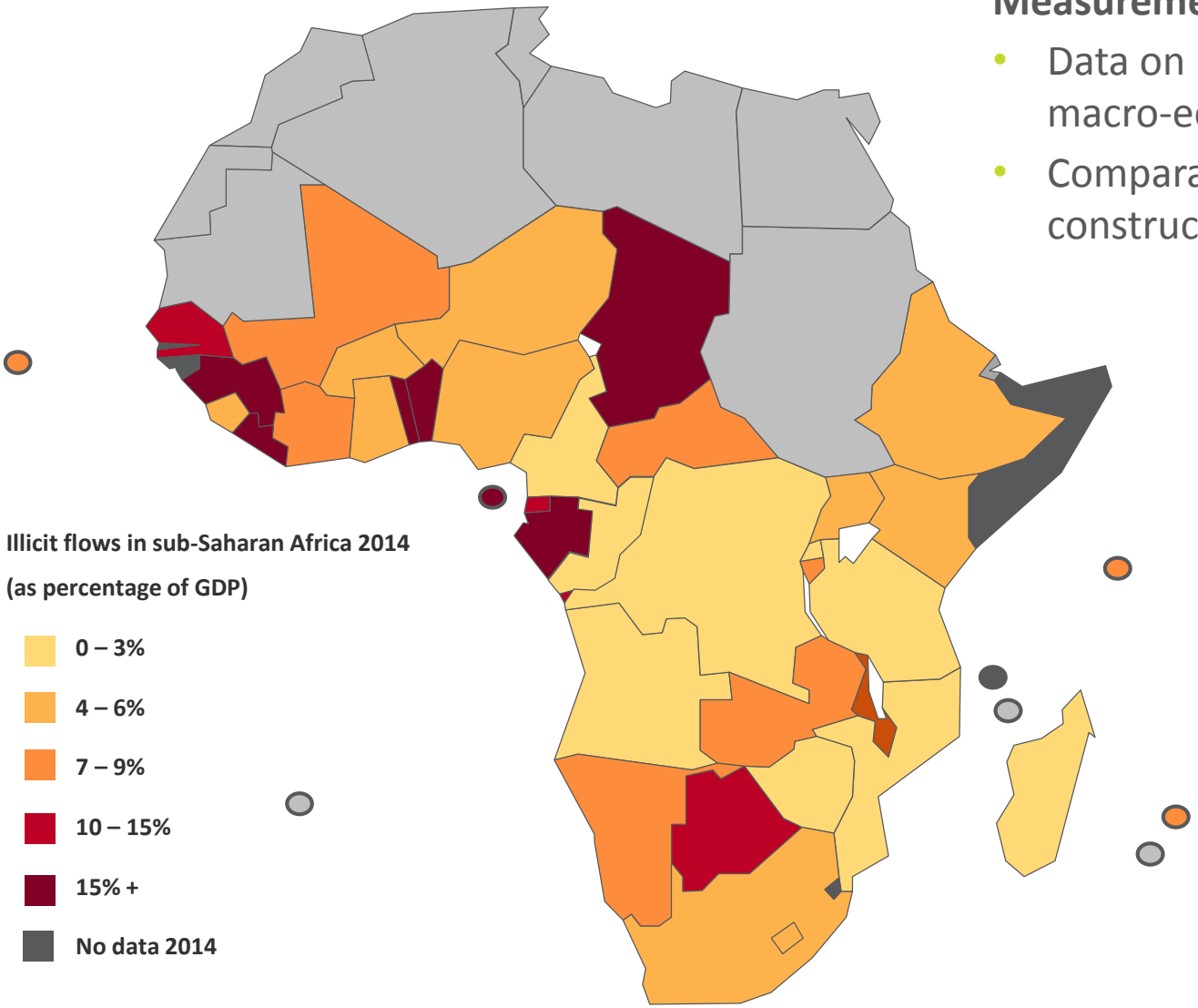
FSDA–Cenfri Inclusive Integrity work

- **Cenfri's financial integrity approach:**
  - Financial inclusion and integrity should be complementary.
  - It is imperative to work on regulation and guidance that are more appropriate for technological advances.
  - Inclusion and integrity should ultimately enhance citizen welfare.
- **Build the case for financial inclusion in financial system integrity**
- **Rationale for considering illicit financial flows:**
  - Mainstream AML/CFT approach focuses on retail
  - IFFs enable ML at wholesale level
  - Proportionality required

What are illicit financial flows?

- **Cross-border capital and resource flows that were illegally earned, illegally transferred or illegally utilised**
  - Illicit financial flows consist of monetary and non-monetary flows; currently only formal monetary flows are measurable.
  - There is an element of unlawfulness or facilitating unlawfulness in either the jurisdiction of origin, transfer, intermediation, receipt or use of the funds.
  - However, not all nefarious flows are classified as illegal in all jurisdictions.
- **Illicit financial flows ≠ Capital flows**
  - Capital flows refer to the legal movement of money across borders due to adverse economic or political conditions.

Illicit financial flows in SSA



Measurement at a macro-level

- Data on illicit flows collected at a macro-economic level
- Comparable to GDP indicator construction

Predicate offences

- Fraud
- Uttering
- Embezzling
- Forgery
- Tax evasion
- Currency and exchange offence
- Statutory corporate governance offences

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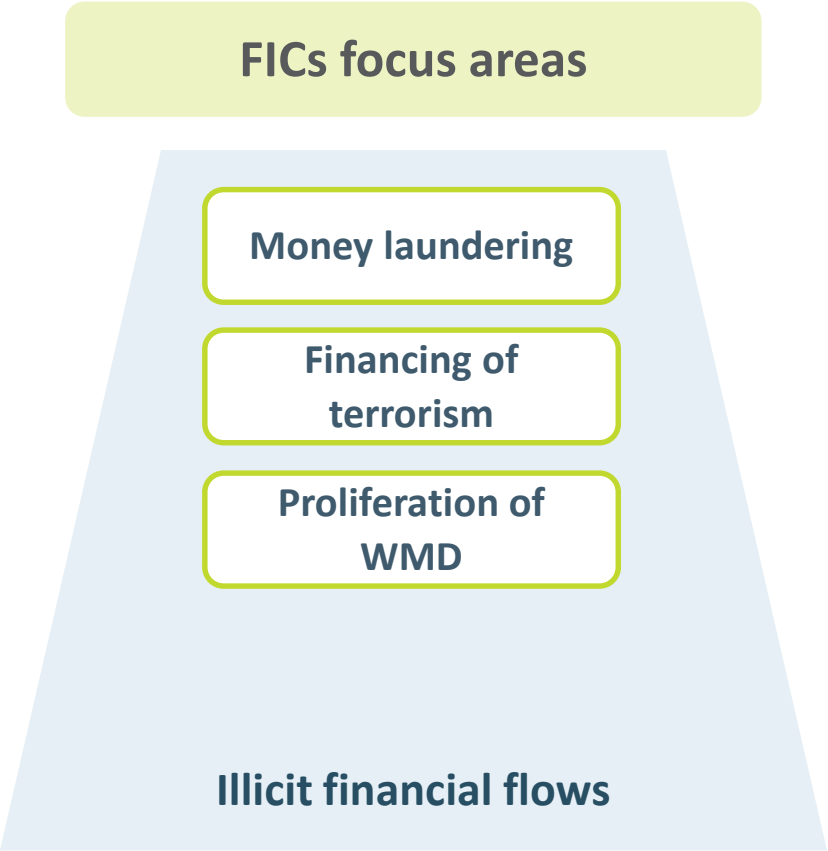
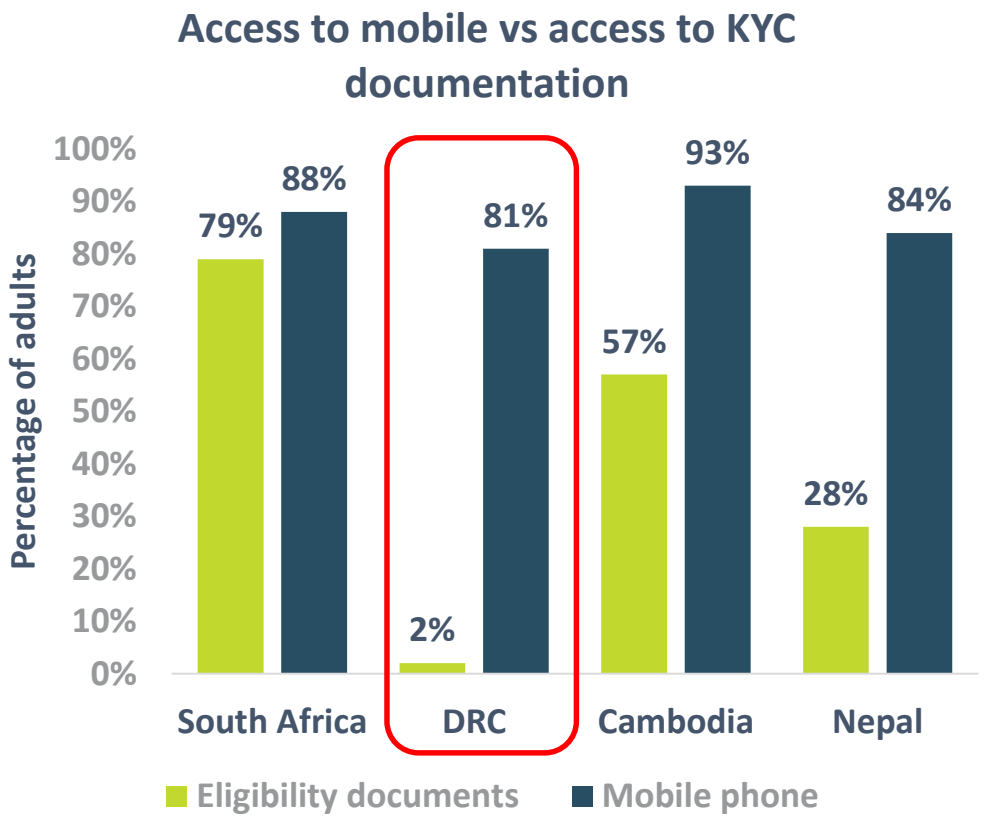
An expanded mandate necessary for FICs



- Traditional financial sector integrity concerns too narrow
- IFF regarded as a trade and capital markets issue
- IFF pose broader risk to financial systems beyond ML-TF risk
- Expanded mandate required for FICs
- High skill and integral data required to combat IFFs
- Need to understand predicate offences
- **Current status quo disproportionately focuses on the retail sector**

Disproportionality drives informalisation



- Excluded and inconvenienced consumers are forced to access informal financial services.
- Informal systems have competitive advantage – not hamstrung by regulation.
- Through technological innovations, informal financial services can offer high-quality and more efficient services to consumers.

- **Disproportionality exacerbates informalisation in the retail sector**
- **Disproportionality encourages shadow banking in the wholesale sector**

RBA solution for illicit financial flows

Paradigm shift to RBA

- The target of financial integrity interventions should be proportionate to avoid driving financial exclusion.
  - Wholesale sector focus vs retail sector focus
- Current AML/CFT focus targets lower end of pyramid to the detriment of financial inclusion.
- FICs require expanded mandate to ensure the wholesale sector's contribution to economic development.
- Illicit financial flows are ultimately a money laundering concern.

New approach

- Measurement
  - Macro-indicators to identify countries at risk
  - Micro-indicators for industry and provider-related risk profiling
- Effective control and measures for wholesale transnational transactions
- Technical assistance for FICs to include Illicit financial flows in RBA

Thank you

Please engage with us:

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About Cenfri

The Centre for Financial Regulation & Inclusion (Cenfri) is a global think tank and non-profit enterprise that bridges the gap between insights and impact in the financial sector. Cenfri's people are driven by a vision of a world where all people live their financial lives optimally to enhance welfare and grow the economy. Its core focus is on generating insights that can inform policymakers, market players and donors seeking to unlock development outcomes through inclusive financial services and the financial sector more broadly.

About FSD Africa

FSD Africa is a non-profit company that aims to increase prosperity, create jobs and reduce poverty by bringing about a transformation in financial markets in Sub-Saharan Africa (SSA) and in the economies they serve. It provides know-how and capital to champions of change whose ideas, influence and actions will make finance more useful to African businesses and households. It is funded by the UK Aid from the UK Government. FSD Africa also provides technical and operational support to a family of 10 financial market development agencies or "FSDs" across SSA called the FSD Network.

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