A guide to adopting an inclusive integrity approach in regulation

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How can regulators align with international best practices? Regulators face the challenge of aligning their frameworks with inclusive integrity principles and international best practices as set by the FATF and other standard-setting bodies. The guide offers a structured approach for integrating financial inclusion with strict AML-CFT measures and includes a how-to guide to align with international standards and best practices as set by the FATF in an inclusive way, and to better engage with their respective markets to identify challenges and opportunities for innovation. Ultimately, this will help to drive down remittance costs and actively contribute to national objectives such as fostering economic growth, building financial inclusion and supporting livelihoods. Finally, the toolkit creates an opportunity for regulators to set the standard for innovation going forward.

Institutions that can be supported by this guide

The toolkit provides practical guidance for regulators on how to: (1) assess the effectiveness of the regulations, identify strengths, and consider which regulations could be acting as barriers to remittance access; (2) identify international standards and best practices, as set by The Financial Action Task Force, to update, upgrade and enhance the regulatory regime through regulatory reform or tools like guidance papers; (3) make practical changes to regulations and/or compliance instruments; and (4) understand and guide the realities of the remittance market.

Who can benefit from this guide?

1. The relevant **financial sector regulators** that can benefit from this guide are Central Banks and non-bank financial regulators, which set the regulatory parameters within which RSPs can operate and innovate, and **financial supervisors**, including Financial Intelligence Units, who evaluate the compliance of financial institutions with laws and regulations.
2. **Relevant departments within the respective institutions** include the Payment System Department, the Financial Stability Department, the Technology and Innovation Department, and the Financial Inclusion Unit. Other departments to consult include the Consumer Protection Unit and Banking Supervisory Department[1].

How this guide[1] can benefit institutions

Benefits of the guide for regulators:

Enhanced regulatory assessment by offering strategies for assessing the effectiveness of current regulations, helping regulators identify risks, strengths and pinpoint barriers that may restrict access to remittances or may risk the integrity of the financial system.

Alignment with international standards by providing a practical framework for identifying and integrating international best practices set by organisations such as the Financial Action Task Force, enabling updates, upgrades, and enhancements to the regulatory regime.

More effective management of cross-border remittances by allowing regulators to gain better insights into how they can leverage technology to monitor and manage remittances.

Facilitates collaboration and knowledge sharing among regulators, fostering a more harmonized approach to remittance regulation globally.

Deeper market understanding by assisting regulators to navigate the complexities of the remittance market, allowing for more informed guidance and policy development.

How to engage with this toolkit:

The toolkit provides a guide for regulators to assess regulations against inclusive integrity goals and best practices. In doing so it covers the following steps as sub-sections:

1. Defining inclusive integrity goals,
2. Aligning with international best practices[2],
3. Amending the regulatory framework accordingly, and
4. Measuring the success of inclusive integrity.

Suggested steps for conducting a regulatory assessment

- **Step 1: Defining inclusive integrity goals[3].** Regulators should start by understanding the relationship between financial inclusion and integrity, recognising the need to pursue these concurrently as outlined by international bodies like FATF and AFI. This section guides regulators on how to define specific national goals that align with broader financial inclusion strategies, how to conduct a regulatory impact assessment, and decide on measurable success indicators that reflect these goals.
- **Step 2: Aligning with international best practices.** This step involves identifying and adopting international standards that support inclusive integrity, such as those set by FATF. Regulators should analyse best practices, consider the local context to ensure the chosen practices are applicable, and identify key regulatory aspects where principles- and risk-based approaches can be implemented.

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[1] The guide provides an overview of how regulators can align their supervisory and policymaking processes with the risk-based approach. The risk-based approach was designed to make supervisors' efforts to detect and prevent the financial flows that enable money laundering and terrorism more effective (FATF, 2021). The risk-based supervision process is designed to consider the most critical risks facing a country's financial system. It also covers the assessment of the financial industry's management of these risks and potential adverse experiences. This process differs from compliance-focused processes, as it focuses on evaluating both present and future risks and effecting early preventative or corrective action moves (Deloitte, 2014).

[2] The guide also provides insight on the resources that regulators can use to enhance innovation, by referring to the reader to e.g. publications by the FATF, European Union Directives, and guidelines by the Bank of International Settlements, among others.

[2] Note: departments differ across financial sector regulators and supervisors; therefore it may be important to identify departments or units with similar mandates.

[3] AFI (2020) describes the ultimate success of inclusive financial integrity as: *"…a situation whereby* ***a safe financial system that*** *has adequate and effective measures in place to identify, assess, understand and mitigate ML-TF risks and to act as soon as the risks have been detected,* ***is equally able to provide greater access to and usage of quality formal financial services*** *in a way that enhances livelihoods and drives sustainable development."*

- **Step 3: Amending the regulatory framework.** After setting the goals and aligning with best practices, regulators are advised to update the existing legal framework. This includes identifying national risks related to financial integrity, assessing inherent risks, consulting international models for comprehensive risk assessments, and tailoring these to the local context[4]. The aim is to ensure the framework is robust enough to manage identified risks while promoting financial inclusion. The section includes practical guidance on how to conduct a national risk assessment and asses the mutual evaluation report to determine which strategic deficiencies can be targeted through updated regulations. This section also includes an overview of how regulators can move from a rules-based approach to a principles-based approach, as seen below.

If you are here:	**Rules-based approach**	Country Y's **due diligence obligations** are framed in a **rules format**. In this case, the due diligence approach to be followed depends on **whether the customer can provide all the required information**, e.g. proof of address, occupation, the purpose of transaction, etc.
You should do this:	Incorporate elements from the **risk-based approach** as mandated by the FATF.	Instead, Country Y should focus on requiring that financial institutions undertake proportionate due diligence. This means **applying documentation requirements that align with the real risks** (informed by data) posed by the customer.
To get to this:	**Principles-based** approach	This can allow for a more **principles-based approach** to consider which attributes are relevant as they inform risk. In the end, this **moves away from setting a rule** to be followed, **to establishing a principle** that a financial institution should implement as they see fit **within their context**.

Example of how regulators can move from a rules-based to principles-based approach.

- **Step 4: Measuring the success of inclusive integrity.** The last step is to track the effectiveness of the updated regulations through a structured monitoring and evaluation framework that measures outcomes against the set goals. Data sources, both internal and external, are utilised to gauge progress. Adjustments are made based on feedback and ongoing analysis to refine the regulatory approach continually.

Each step in this process is crucial for creating a balanced regulatory environment that fosters both financial integrity and inclusion, ensuring that financial systems are both secure and accessible.

This guide forms part of a broader remittance innovation toolkit which can be accessed here.

[4] Key risks related to financial integrity to be assessed include compliance, illicit financial flows, money laundering, proliferation financial and terrorist financing risk as well as risk of financial exclusion, to name a few.