International Payments Compliance in Support of Globalisation

The world of international payments is an exciting and growing business opportunity. Increased global movement of people and capital for positive reasons - more flexibility and harmonisation of European Economic Area (EEA) labour and financial markets or the greater ease of cross-border movement of people for recreational purposes - or for negative ones based in the diaspora of peoples driven by geo-political forces; combine to create an increasing need for individuals and smaller businesses to access low-cost and secure cross-border financial services.

Challenges

Concerns that organised crime has used legitimate financial services to realise the value of criminal behaviour, or worse that terrorists have abused the system to fund the atrocities that have been executed across the globe in recent years, has led to a co-ordinated raft of national and supra-national Anti-Money Laundering (AML) legislation directed at preventing the utilisation and abuse of financial services by criminals aiming to realise the benefits of their crimes, and a further suite of laws designed to Counter Terrorist Financing (CTF).

Defining and implementing the kind of risk control framework that can meet all of the (sometimes conflicting) obligations of an international payment facilitator, and that will support clients and partners in meeting their own obligations requires a deep understanding of the related risks and of the process of applying a risk-based approach to the management of those risks. Accountability sits collectively with all stakeholders: legislators, regulators, law enforcement, the businesses themselves, and even (though to a lesser extent) the consumer.

Despite attempts to harmonise AML/CTF legislation across the globe, multi-jurisdictional compliance is a challenge, and one requiring particular expertise, not least because countries’ legal systems have very different underpinnings (adversarial vs. inquisitorial, common law vs. statute) and therefore the implementation of legislation and the procedures that facilitate it via law enforcement and the judiciary will be very different.

In the UK, non-bank payment institutions can be authorised and regulated under the Payment Services Regulations (PSR) 2009 as Authorised Payment Institutions (API). This designation means the institution is regulated by the Financial Conduct Authority (FCA) and is required to have validated capital holdings, a commitment to consumer protection and a safeguarding strategy for client funds. The designation also means that all the company’s directors and relevant officers will have passed the FCA fit and proper persons tests, and that the company will be subject to the kind of regular supervisory visits and ‘audits’ that in other jurisdictions (e.g. the US) are normally only applied to banks. This category of financial institution, and the level of supervision accorded to it, simply doesn’t exist outside of the European Union (EU) which makes it difficult for regulators outside of the EU and correspondent banks to assess the nature and risks of doing business with such entities.

Similarly, being a Money Service Business (MSB) may have an equivalent meaning across many jurisdictions in terms of the business activity undertaken, but it does not mean that the entities’ activities are regulated in the same way across multiple jurisdictions.

Moreover, some regulations require financial organisations to meet the standard of their home jurisdictions regardless of where their business operates. For instance, the FCA requires UK financial service providers to apply the same compliance standards regardless of the country they operate in.

This poses further challenges for international financial service providers and even for their customers, as it is not always clear what their rights and obligations are, or what protection they have.

Some regulatory conflicts are straightforward almost to the point of absurdity. For instance, the US includes Cuba on the list of sanctioned countries on a par with Iran, and severely penalises payment providers that facilitate payments to/from the island. This conflicts with specifically designed EU rebuttal regulations which make active compliance with the US embargo of Cuba a breach of EU legislation.
Clearly then, it is impossible for cross-border payment providers to comply with both regulations. As a result firms need to identify the business model that has the most value for them and be prepared to defend their position. Ultimately a compliance decision here becomes a commercial one for most firms. In practice, as the US is the biggest market and the most active enforcer of compliance with its sanction regime, most firms will focus on staying compliant with the US regime.

The ‘rules’ of individual regimes reflect a very different approach to the idea of a particular ‘control’. For example, transaction reporting rules in the US are based on thresholds and require financial organisations to report on all transfers above designated amounts. The UK suspicious activity reporting model on the other hand, as its name suggests, is based on evaluating the risks of each transaction and reporting those that meet a subjective criteria of ‘suspicious activity’. These two sets of reporting obligations might be argued to reflect fundamental differences in approach (despite both being Financial Action Task Force (FATF) members) by the US and the UK, reflecting a commitment to or focus on a rules-based and risk-based regime respectively.

Managing payments in a world with such conflicting regulations requires businesses to further develop the risk-based approach’ that focuses on continuously monitoring and dynamically evaluating multiple risk factors. Proper understanding and application of the risk-based approach offers flexibility to financial organisations in addressing compliance concerns based on the level and nature of risk rather than on strict static internal rules designed to reflect multiple, and sometimes conflicting, external regimes.

International regulatory bodies like FATF, as well as UK and European regulators have already demonstrated their commitment to the risk-based approach and the requirement to implement controls that are appropriate to the identified risks, based on an assessment of the nature of the business, clients, location and channels used for delivery of the services.

**Unifying Global Compliance Standards**

There are various initiatives to unify national, regional and global compliance standards, e.g. US IAT rules, the Single Euro Payments Area (SEPA) regulations, and of course FATF VII, each of which touches upon harmonising ‘cross-border’ data requirements for payments.

Nonetheless practical challenges remain. Current sanction screening tools only recognise Latin and Greek alphabets, whilst a lot of data in international payments comes in Cyrillic or other alphabets. Financial organisations are simply not equipped with the right tools and systems yet to guarantee compliance when faced with data in unusual script.

Moreover, whilst over time technology standards are starting to reflect any consensus around regulatory requirements, there isn’t one regulatory framework that can be applied regionally or globally to unify compliance requirements.

**Risks**

The consequences of breaching any of these complex technical and/or diligence related obligations are wide-ranging and potentially severe. They are aimed at individuals as well as corporations, and various states have proved more than willing to impose the most punitive of measures including fines into the billions of $USD, loss of licences to operate in the field (for firms and for individuals) and imprisonment. A brief investigation into enforcement actions over recent years shows a steady rise in the number of jurisdictions taking punitive actions against perceived transgressors, and in the number of cases, and the severity of, the actions taken.

**Is regulation always serving its purpose?**

In February 2013, the FATF, the supra-national body that sets the legislative framework that countries must have in place to address AML and terrorist financing issues, and which aims to unify such rules across countries, published a paper (supported by the World Bank) titled ‘Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion’.

The paper identifies the risk that overly prescriptive regulation encourages a no-risk approach to international remittances which excludes millions of people from access to global remittances (e.g. those in the developing world, the rural poor etc.) and inadvertently neuters the monitoring processes of legitimate financial service providers by forcing criminality away from properly regulated institutions which are charged with feeding crucial information (suspicious activity) into law enforcement’s oversight mechanisms.

FATF therefore recognises the need to address this apparent issue and does so by further strengthening its support for the ‘risk-based’ approach (i.e. the application of appropriate controls, based on an understanding of actual risk, specific to the individual entities’ business activity). It provides examples of the sorts of global consumers currently excluded from financial services, and how financial service providers such as Earthport could and should be supported in applying the risk-based approach (as Earthport already does) going so far as to give examples of lower risk transactions which should be encouraged.

---

In Africa providing microfinance to women is one of the most effective ways of helping small communities to develop the means for their businesses to grow and provide some financial stability. Ten years ago micro-financing to Africa was starting to boom. There were major institutions looking to offer micro-financing in this market. But the burden of meeting all regulatory requirements and the black and white approach to enforcement of these compliance rules seems to have resulted in some of the major banks retreating from the micro-finance business area. Regulatory frameworks must work to facilitate financial inclusion, not hinder it.

**Establishing best practice**

To be able to overcome the challenges, industry participants need to understand that compliance is not only about adhering to legislation. It is a journey, and one on which the aim is to get closer to what we all want – assurance that legitimate financial services are not abused by criminals and terrorists.

To be able to move forward on that journey we need to be constantly developing new tools, reassessing operations, devising better products, more secure systems, improving IT and communications. This includes enhancing automated solutions, system communications, and communication between clients and service providers, regulators and the regulated, and law enforcement of the industry.

As identified in the aforementioned FATF paper, the risk-based approach offers the best way forward, but stakeholders need to recognise that this will inevitably mean occasional materialisation of risk. Risk occurrences must be seen in the context of a cycle of improvement of the regulatory framework and should not be automatically identified (by enforcement agencies or by the larger correspondents) as a measure of the failure of the control regimes of the smaller players in the market or the countries that have less developed communication systems. Otherwise those underserved by financial services will find it even harder to access the services they need to bring about economic development.

**Earthport’s solution**

As expert providers of low cost international payments, Earthport products and services are a fully transparent, stable, secure, predictable and technically compliant end-to-end payments solution, but of even more importance to our clients (and to our banking partners) is that the access we provide to an ever increasing number of countries is supported by Earthport’s expertise in managing safe market entry for our business (licences, registrations, local partnerships, physical presence etc.) and therefore for their businesses, ensuring that all payments meet the myriad technical, due diligence and screening requirements of all the jurisdictions they touch upon, and in negotiating the inevitable conflicts between the various regime requirements, and even the risk appetites of the many players in any end-to-end international payment chain.

Earthport demands that its compliance function is an expert trusted advisor to the business, overseeing a robust, integrated and effective compliance risk control framework. Bringing life to this vision means engaging with the business daily, and across all areas; from product development through the sales cycle and client integration phases, in addition to client on-boarding and relationship management. Earthport understands that compliance is core to the offering; it is at the heart of what we do. We are not just about safely servicing client payments across their current business footprint, but we enable and support clients who want to move from domestic to international payments or who wish to expand regionally or continentally in other ways.

**Negotiating the inevitable conflicts between the various regime requirements, and even the risk appetites of the many players in any end-to-end international payment chain.**

**Partnership approach**

To be able to move forward, all players need to recognise that there are a lot of participants in an international payment environment: originators, beneficiaries, utility providers and payment aggregators, correspondent banks in different countries etc.

All participants in this value chain need to be committed to helping each other to meet their obligations as well as being dedicated to meeting their own. Often organisations that are devoted to maintaining their own high compliance standards are not as sensitive to the needs of other entities in the value chain.
Participants need to understand their banking partners’ obligations and the relative reliance each entity can place on another entity in the correspondent banking chain.

One of the challenges to achieving transparency for instance, is the difference in regulatory mandates about data protection and privacy across countries and the lack of sufficient collaboration between financial organisations on data protection.

Participants need to understand their banking partners’ obligations and the relative reliance each entity can place on another entity in the correspondent banking chain. The means and the ability to legitimately place reliance on other participants in the chain is essential to improving the international regulatory ecosystem and fostering the innovations in payments which will serve the market, especially those currently under-banked or unbanked. Big business and wealthy individuals, including serious organised crime, are simply not challenged in the same way, as they can afford and/or will pay the cost of such ‘blanket’ compliance measures; measures which are often the inevitable consequence of a failure to understand, implement and accommodate the risk-based approach.

The global financial services industry won’t meet these challenges without greater transparency of proprietal decision making (risk appetites etc.) and/or understanding partner requirements. Where there are fewer members in the end-to-end payment chain, such as where a service like Earthport’s is inserted into the chain, it will be easier to communicate and properly legitimise those relationships.

By collaborating on these issues and understanding the hierarchy of obligations that different entities have in terms of data privacy, organisations will be able to achieve more transparency and ultimately more effective payment services.

Andrew H. Brown
Head of Compliance, Money Laundering Reporting Officer (MLRO) and Nominated Officer

Andrew H. Brown has served as Earthport’s Head of Compliance since 2012, providing leadership, direction and oversight across all financial crime and regulatory compliance issues including Anti-Money Laundering (AML), Counter-Terrorist Financing (CTF), Anti-Bribery and Corruption (ABC), data protection and fraud.

With 18 years experience of law enforcement and criminal investigation Andrew became specialised in international banking and card payment crime. Risk is a common thread throughout Andrew’s 30 year career which includes experience in international banking with ING and Barclays, law enforcement for the UK and Royal Cayman Islands Police Services, regulation for the UK National Criminal Intelligence Service and corporate compliance at Royal Dutch Shell. He is a Certified Professional Fellow of the International Compliance Association.