**Institute of Advanced Legal Studies**



De-risking; assessing the consequences of enhanced anti-money laundering and counter terrorist-financing regulation on access to finance.

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**Introduction**

‘De-risking’ is when banks reduce their exposure to activities, clients or regions that are associated with higher terrorist financing (TF) or money laundering (ML) risk.

Disproportionate de-risking is when financial institutions chose to exit higher risk business relationships instead of taking additional steps to mitigate the ML/TF risk.

De-risking has historically had a broader meaning in finance and referred to the process of reducing exposures to a particular asset classes, market risk or portfolio concentration. In the wake of the financial crisis de-risking was used to describe the process of restructuring balances sheets to better withstand financial shocks. The term did not become associated with the closure of “higher TF/ML risk” business relationships until after 2009 (FX Trader Magazine, 2009)

As a result of several high profile reports of disproportionate de-risking, regulators and international bodies have become concerned about the consequences of de-risking on financial inclusion. There are growing concerns that as banks have looked to reduce their exposure to high risk clients and have left many people and businesses without access to banking services.

In the UK there are also concerns that “de-risking” has led to discriminatory outcomes and has further financially excluded members of certain minority groups. There is the risk that people and businesses that share characteristics with those who are associated with terrorism and financial crime have been excluded from financial services despite having no affiliation with such groups or activities. Moreover some commentators believe that banks have used compliance with increased anti-money laundering (AML) and counter-terrorist financing (CTF) legislation as an excuse to exit unprofitable banking relationships and reduce competition.

At an international level there are concerns that the decisions to exit “higher risk” banking relationships have significantly affected access to the global financial system. This has particular consequences for vulnerable regions and may destabilize countries dependant on remittances limiting opportunities for growth and development.

Despite widespread media accounts of disproportionate de-risking the true extent of the de-risking there has to date been limited academic study of the area and relatively little case law to draw from. This study will provide a comprehensive overview of the current public discussion on de-risking. This will bring together media sources, relevant case law and legislation with think tank reports and studies on financial inclusion to assess the consequences of de-risking. In doing so Chapter 1 will explore the current regulatory environment and Chapter 2 will establish the drivers of de-risking from an industry perspective. Chapter 3 will assess the available evidence to understand the extent to which de-risking has taken place and who it has affected. Chapter 4 will considered the unintended consequences of de-risking and Chapter 5 will examine the impact of de-risking on financial inclusion. Finally Chapter 6 will consider who has responsibility for addressing the consequences of de-risking and assesses potential policy interventions. This study concludes that the cost of regulation and increased legal liability for banks has driven disproportionate de-risking in the UK. This disproportionate de-risking has particularly affected money service business and member of certain ethnic minorities but has not had a significant impact on general levels of financial inclusion in the UK. Internationally de-risking has significantly affected countries dependant on remittances and will require public and private sector collaboration to remedy the unintended consequences of de-risking.

Chapter 1 - The enhanced regulatory environment

Following 9/11 tackling terrorist financing became a global priority. The “War on Terror” introduced a series of more intrusive counter-terrorist measures ranging from enhanced airport security to increased personal surveillance. It also included a specific focus on tracing, identifying and disrupting sources of terrorist financing to “starve terrorists of funding”.

New AML/CTF regulations were quickly introduced. UN Resolution 1373 criminalised terrorist financing. The US, Article of the Patriotism Act 2001 introduced new powers to detect and prosecute terrorist financiers. The UK passed a series of terrorism acts (2000, 2005, 2008) that granted authorities wider powers to prevent and prosecute terrorist financing. New AML/CTF requirements were introduced through the European Anti-Money Laundering Directives (2001, 2005, and 2015). Each of these regulations has increased the monitoring, due diligence and reporting requirements for financial institutions. (Keatinge, 2014)

**International Standards**

The Financial Action Task Force was established in 1979 as the international standard setting body for AML policy. It publishes a series of soft law recommendations that describe best practices for a risk-based approach to AML and CTF. It also monitors compliance with its recommendations and produces typologies of the evolving money laundering and terrorist financing methods. These recommendations represent internationally agreed standards of best practices for tackling money laundering and terrorist financing and have been converted in regulation by a number of European and domestic directives. However, there are now many examples of banks choosing to “de-risk” rather than applying these international standards to high risk clients.

The Charity Finance Group argues that de-risking has been “disproportionate” has not been in line with FATF's risk-based approach which involves enhanced customer due diligence and transaction screening to detect suspicious activity. (Charity Finance Group, 2015)

This risk-based financial approach is different to enhanced airport security measures. The airline industry has new passenger security regulations but unlike the financial industry does not have to monitor the flight history of customers from “higher risk” jurisdictions. With respect to air travel, governments and border control agencies take an active role in monitoring, tracking and detaining individuals associated with terrorism and organised crime. In finance the government produces blacklist of suspected terrorists but does not have the equivalent public function of border control to monitor and detect and sources of terrorist financing. Regulation has in effect outsourced the responsibility for detecting terrorist financing and money laundering to the private sector; to the lawyers, estate agents and financial institutions who are compelled by regulation to monitor their customers transactions and freeze their assets on behalf of the government. It is an important question, the appropriate limits of the private sector for funding and conducting what is arguably a public function. When banks choose to de-risk and exit “high-risk” relationships, this public function is lost as government have not developed the capacity to screen transactions themselves.

**High-risk characteristics**

The 3rd EU AML directive requires enhanced monitoring and due diligence for transactions associated with “higher risk factors”. What is understood to be higher risk, is established by FATF’s research into emerging methods terrorist financing cover high risk customers, businesses and jurisdictions.

**Customers**

The FATF typologies focus on non-profit organisations, who are at risk of being used as legal fronts for terrorist financing. (Financial Action Task Force, 2012) The typologies provide examples of NGOs being used both knowingly and unknowingly as channels for funding terrorism. The financial characteristics of NGO activities have similarities to that of terrorist financing. Terrorist financing requires the international collection, transfer and distributions of funds from multiple donors. Charitable financial activities follow a similar pattern. Their humanitarian status often means they are implicitly trusted and have access to vulnerable regions and conflict zones which other businesses would be unable to operate in without raising suspicion. These traits have been exploited by terrorist groups that have used NGOs as channels for terrorist financing. Others terrorists have misappropriated funds from legitimate NGO projects by posing as aid workers. (Financial Action Task Force, 2013) The UK the charities commissioner has opened full statutory investigations five Muslim charities that are operating in Syria that due to poor management controls and relationship with to aid workers were have been linked to terrorism. (Metcalfe-Hough, Keatinge, & Pantuliano, 2015)

FATF offers no specific guidance as to how to monitor the financial activity of religious organisations, but does highlight that their charitable and educational outreach work has been used to recruit and promote terrorism. It also provides examples of religious institutions funding terrorist activities directly (Financial Action Task Force, 2013).

FATF also recommends that Politically Exposed Persons (PEPs) should be subject to enhanced due diligence. These are people that hold “prominent public positions” in politics, diplomacy, the judiciary, and the military. (Financial Action Task Force, 2013) PEPs may control budgets and/or have responsibilities for awarding contracts and grants that may be misappropriated. FATF has found evidence of positions of influence being “abused for the purpose of money laundering and terrorist financing” and as such has indicated that the financial transactions of PEPs, in particular foreign PEPs, should be subject to enhanced monitoring.

**Business activities**

FATF recommendation 12 identifies correspondence banking as an activity that carries a higher ML/TF risk. Correspondent banking involves moving money through layers of financial intermediaries to provide services to customers where banks do not maintain a branch network. This increases ML/TF risk as there is no direct “face to face” relationship with the underlying client. (Financial Action Task Force, 2012) Correspondent banks have to rely on the quality of controls that respondent banks have in place to meet “know your customer” requirements. This risk is increased in jurisdictions that have poor compliance with international money laundering regulations and maintain bank secrecy laws.

FATF also recommends enhanced controls for Money Services Businesses (MSB). They also have characteristically more “one off” relationships with a wider range of customers so lack the ability to notice changes in their customer’s behaviour and detect suspicious activity. With no central oversight of customer transactions money launders can use multiple unconnected MSBs to layer their transactions and avoid detection. MSBs based in the UK were used to fund the Madrid bombings (Bayot, Disneur, & Kempson, 2014). Moreover some organised criminal organisations operate their own “legal” MSBs and use them as a channel to launder money without detection.

MSBs are also widely used by migrant workers as a quick and cheap method of sending remittances back to countries where banking services are limited. The widespread use of MSB for remittances conflates transactions of legal and illegal origins and makes it more difficult to identify suspicious transactions.

**Jurisdictions**

Financial institutions have also de-risked by reducing their operations in higher risk jurisdictions. Higher risk jurisdictions are those that do not comply with international AML/CTF standards or are more unstable as a result of poverty, conflict or terrorism. FATF produced a list of high risk jurisdiction, other watch–lists and black-lists are published by various international organisations such as the Basel index and the EU consolidated sanctions list (Basel Institute of Governance, 2015) (HM Treasury, 2015). New and existing customers are screened against these lists for involvement with organised crime and affiliation with terrorist groups.

Chapter 2 Drivers of de-risking

This chapter discusses the different drivers of de-risking. At the heart of the issue is the increased cost of ensuring that ML/TF risks are appropriately mitigated and controlled. As discussed previously the cost of maintaining detection, monitoring and reporting capabilities which can be considered a public good is paid for by the private banking sector. Banks are required to conduct this public function and monitor their customers for suspicious activity. However banks have the discretion to choose their customers on a commercial basis which means if they choose not to engage with certain customers then this public function will be under-performed.

**Cost of compliance**

Increased AML/CTF requirements

Given the amount of regulation they are subject to banks argue that the cost of compliance has made certain business lines unviable and led to the reduction in service to high risk customers, businesses and jurisdictions. Truman estimate the cost of the compliance with AML/CTF regulation in the US is $7 billion annually. (Reuter & Truman, 2004) KPMG estimated that the cost of compliance with AML/CTF legislation has risen 53% from 2011-2014 and will continue to rise (KPMG, 2014). Since being fined in 2012 for serious breaches of AML regulations HSBC has committed to investing $700million to improve “know you customer” systems. (Ready-Made Investment Digest, 2014)

KPMG found that transaction monitoring and the ‘know your customer’ requirements (KYC) impose the most significant cost to firms. (KPMG, 2014) Geiger argues that the cost of compliance with AML/CTF requirements accounts for 45% of the total regulatory burden. He also notes that the cost of compliance is felt disproportionately by smaller firms who rely more heavily on manual transaction screening. (Geiger & Wuensch, 2006) This significantly increases staff training costs and could have an adverse effect on the ability of smaller firms to compete effectively as larger firms are able to use insights generated by their automated systems about their customer’s behaviour to better target the sales of other financial products. (Tsingou, 2005)

The evolution in payments technology has increased the range of money laundering channels and techniques. Large on-going systems investments are required to ensure that firms can keep up to date with the latest money laundering techniques. This means that independently of any additional regulatory requirements there is an on-going cost to maintaining and updated detection and reporting systems. These systems are increasingly sophisticated. Private compliance tools such as World-check are able to screen customer details against hundreds of different sanctions lists as well as thousands of different media sources in multiple languages. They claim to have detected 180 high risk individuals before they appeared on official sanctions lists (Thomson Reuters, 2015).

Moreover the number of financial transactions that have to be monitored has increased significantly. Between 2008- 2012 the annual number of electronic transactions processes in the UK has increased from 15 billion to 18 billion (Capgemini, 2013). This trend will continue as more transactions are processed online and through apps. This means that financial institutions will have to monitor an increasing number of diverse online transactions which will again increase the cost of compliance.

Increased Prudential costs

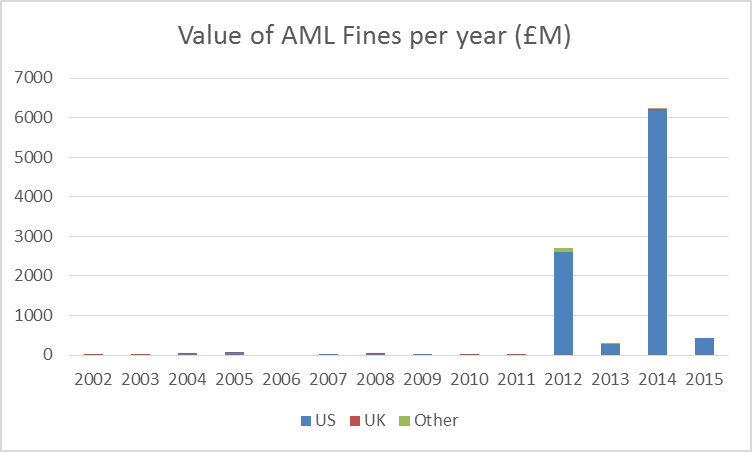
Since the financial crisis, prudential regulatory requirements have increased. In an effort to ensure that financial institutions are sufficiently capitalized banks now have to holder higher amounts of better quality capital. Higher capital ratios can be achieved through holding additional capital reserves for the risks that banks are exposed to or reducing the amount of risk recorded against the balance sheets.

A report published by the Bank of England in 2014 demonstrated that the effect of increased capital requirements had been two-fold; banks had increased the quantity and quality of the capital they held and cut corporate and secured household lending activities to reduce the risk recorded against their balance sheets (Bridges, Gregory, Nielson, Pezzini, Radia, & Spaltro, 2014). After the prudential reforms these activities had become more capital intensive and were cut to lower the amount of capital that banks had to hold. An FSA paper revealed that the banks had first looked to cut the amount of lending and then had chosen to de-risk their loan books to drive up the quality of the loans on their balance sheet and reduce the amount of capital they have to hold.

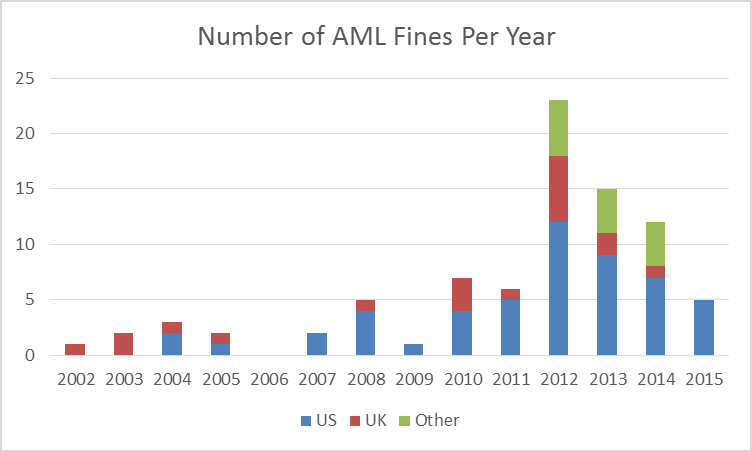
CRD IV does not directly require banks to hold additional capital against ML/TF exposure. However national supervisors can increase capital requirements for poor AML/CTF systems and controls. This “capital uplift” focuses on the geographical location of exposures and the strength of internal processes and procedures. CRDIV’s focus on geographical exposures also means that conducting business in certain areas will be more capital intensive. This could provide a prudential incentive for large banks to de-risk and to withdraw from certain foreign markets.

**Cost of non-compliance**

Others suggest that de-risking has been caused by the increased number of regulatory sanctions issued for AML/CTF breaches. Over the past 5 years there have been a number of high-profile fines for weak anti-money laundering controls. The graphs below show the total number of sanctions imposed globally for breaches of AML/CTF regulations and the total volume of the fines.



* **Figure 1 - Value of AML fines from 2002-2015**



* **Figure 2 –Number of fines for breaches of AML regulations by jurisdictions**

Figure 1 and 2 demonstrate large increase both in the number of cases and the average value fines. Figure 1 show the annual fine volume ranged between $750,000 to $22 million. In 2012 HSBC paid a record fine of $1.9 billion to US regulatory authorities for lack of oversight of a Mexican branch which laundered $800 million. HSBC was also reported to have moved money for groups on the US sanctions lists and known terrorists (Financial Conduct Authority, 2014). In 2014 Standard Chartered was also fined a total amount of $670 million for not taking due care in monitoring corporate customers that had links with PEPs.

These enormous fines had an upward effect on the size of regulatory fines issued for AML/CTF. In 2014 BNP Paribas was fined $8.9 billion for “violation of its responsibilities to identify limit and monitor the inherent risks associated with international transactions” (BBC, 2014). This amount equalled the total pre-tax income of BNP Paribas. Given the size of these fines, it is reasonable to assume that it would affect a bank’s AML/CTF risk appetite. One way to mitigate this would be to invest in enhanced systems and controls and training to improve the ability of staff to detect and monitor AML/CTF risk. Alternative options would be to reduce the services offered to customers and in locations that are considered high risk.

Figure 1 demonstrates the disproportionate volume of the fines issued by US regulators. This would suggest that financial institutions that had operations in jurisdictions that were affected by the US regulator law would have a greater incentive to de-risk. Since 2002 the UK has issued a number of fines for AML/CTF breaches but these have not been in the same order of magnitude as those issued by US regulators. The FCA’s largest fine for AML (£8.75 million) was issued against Coutts bank for poor handling of PEP accounts. The FCA also recently fined the Bank of Beirut £2.1 million for AML breaches and prevented them from taking on any new business in high-risk jurisdictions for 130 days (Financial Conduct Authority, 2015). This restriction of business is the clearest example of direct regulatory intervention that has led to de-risking.

It is only from 2012 onwards that other jurisdictions outside of the UK and US start to bring forward cases and fines for breaches of AML/ CFT. Of these India, South Africa and Mexico are the jurisdictions that have issued the most fines by number and value. Israel and Argentina have issued single fines in the range of several million US dollars. However these amounts are fairly minimal in comparison to the US fines. One might predict that de-risking is not likely to be an issue for financial institutions based in jurisdictions that have not pursued AML/CFT breaches as aggressively as the US and the UK.

If you assume that de-risking was influenced by the size and number of AML/CTF fines you might expect that de-risking would increase significantly after 2012. The chart below represents the number of Google search results that feature both the terms anti-money laundering and de-risking. The graph demonstrates that the number of results that reference the de-risking and AML more than doubles between 2012 and 2015. In fact the number of results published in first half of 2015 shows that the public discourse around de-risking is still growing and is estimated to hit 560 by the year. This demonstrated that de-risking is a current and growing phenomenon in public discourse that has seen large growth since 2012.

* **Figure 3 – Number of search terms published each year containing referencing AML and de-risking**

**Cost of legal action**

Other commentators suggest de-risking has been led by the increased legal liability that banks and other financial institutions incur by processing funds linked to terrorism. In America there have now been 14 separate cases raised under the US anti-terrorism act between 2003 and 2014 that have sought to take legal action against banks for their involvement in facilitating the movement of funds to institutions that have been indirectly linked to terrorism. A number of plaintiffs have sought to recover damages for the deaths of family members caught in terrorist attacks whilst on active service in the Middle East. The banks are charged with processing funds for charities and institutions that were indirectly affiliated with terrorist groups but did not appear on official sanctions list. These cases demonstrate that even full compliance with the existing regulatory regimes does not insulate financial institutions from liability with regards to terrorist financing.

The case brought against Arab Bank PLC set a historic precedent for the liability of banks internationally (Courtney Linde, et al. v Arab Bank, PLC,, 2013). This was the first civil case brought against a financial institution for the facilitation of terrorism. The plaintiffs alleged that the bank acted as a “conduit” for funding to Hamas and as a result facilitated a number attacks from 2001-2004 (Bob, 2014). The bank was found to be liable for the attacks committed by Hamas as there was evidence that it had processed automatic payments to charities that had been linked to Hamas but were not listed on official blacklists. The court ruled that there was no requirement for a direct causal link to be established between transfers and the terrorist attacks, but rested on a “but for causation”. (Courtney Linde, et al. v Arab Bank, PLC,, 2013) The “but for” test in tort law asks, “but for the defendant's actions would the claimant have suffered loss?” The courts decided in the case of Arab Bank that the answer to this question was no and found that Arab Bank was “wilfully blind” to the underlying purpose of its customers’ transactions.

At the centre of this case were a number of documents that Arab Bank could not provide to the American authorities due to Palestinian Bank secrecy laws. Based on the evidence it had already seen and the Arab Banks’ inability to provide the requested documents the judge allowed the jury to infer that the Arab Bank willingly provided financial services to terrorist organisations.

This case sets a new precedent for banks; that despite compliance with regulation they can still be found liable for the activities of their customers. It set a higher standard of due diligence than is required by regulation and creates legal uncertainty about the liability of banks for the actions of their customers’ affiliates. Taking this conclusion to its extreme: a bank could be found liable for any crime a customer commits by virtue of the fact that it processed transactions on their behalf. This would be an extremely strong and dangerous precedent to set and is one still being challenged by Arab Bank on the second circuit.

The judge found Arab Bank guilty of willingly assisting Hamas to conduct 23 terrorist attacks. The damages that the bank will have to pay is currently unknown and may amount to hundreds of millions, significantly exceeding regulatory fines

Following the success of the Arab Bank case in 2014, the same attorney Mark Werbner, has launched a new class action Freeman vs HSBC et al. This case seeks damages from five European banks who were alleged to have proved financing to Iranian institutions and are consequently being charged with liability for the deaths and injuries of American soldiers in Iraq. The plaintiffs allege that the banks purposely worked with Iran to disguise the origins of payments to evaded US sanctions. (Freeman et al V. HSBC Holdings PLC, 2014)

A separate case was brought against the Bank of China (Elmaliach v Bank of China Ltd., 2013) for transferring funding to groups associated with Hamas. The case was launched with the support of the Israeli government who provided evidence and encouraged plaintiffs to sue the Bank of China in order to cut the flow of funding to Hamas (Frankel, 2014). This case is interesting as the Bank of China breached US sanctions, however in China Hamas is not considered a terrorist organisation.

These cases raise pertinent questions about who has the authority classify people as terrorists. The development of advanced screening systems has meant that bank have been able to detect a potential terrorist before they appear on international sanctions list. Here there is a clear duty for the banks to report their suspicions to the relevant enforcement authority under the Proceeds of Crime Act, but should it be for the banks or government authorities to decide whether as a result these people should continue to have access to finance? The Proceeds of Crime Act also makes it an offence to be in an arrangement in which he “suspects will facilitate another person to acquire, retain, use or control criminal property” which would mean that banks have an obligation to close the account of individual it suspected of financial crime. (UK Government, 2002)

Other cases have taken a more proportionate approach to a bank's liability for its customer’s actions. In Rothstein vs UBS, UBS was alleged to have processed hundreds of millions of dollars for the Iranian government in violation of US sanctions. However, when the families of the victims of the bombings tried to sue UBS for the damages they could not demonstrate that the banks were “proximately responsible for the injuries” of the victims. Here the plaintiffs were required to prove higher standard of causation to hold that the bank was liable for the actions of the Iranian government than was required in the Arab Bank cases.

The uncertainty about the limits of a bank's liability for its customer’s actions create legal risk for financial institutions when processing transactions in high risk locations. It undermines regulation standards and forces banks to gold plate regulation. All of this brings cost; the cost of development of more sophisticated systems; the potential cost of damages and the reputational damage of being associated with money-laundering or terrorist financing regardless of the outcome of these cases. Given the precedent setting case of (Courtney Linde, et al. v Arab Bank, PLC,, 2013) we can only assume there will be more challenges in the future

Again it is interesting to draw parallels between the liability faced by financial services institutions and those in other industries. Looking at the airline industry, if an airline provided transportation to an individual, who then went on to commit a terrorist attack, victims would not be able to sue the airline for providing a passage to a customers that it had no reason to suspect was associated with terrorism. Indeed there has been no class action that has ever been raised against an airline for their involvement in facilitating a terrorist attack. It would seem then that the financial sector is subject to a higher standard of liability for indirectly assisting terrorists. It is not clear why the financial sector that has taken on the responsibility and cost for the screening of financial transactions and customers to increase security of the financial system on behalf of the public and is at the same time is being held liable for the actions of its customer affiliates.

The combination of the cost of compliance with AML/CTF regulation, the cost of non-compliance with AML/CTF regulation and the cost of liability for indirectly assisting terrorists means that the cost of doing business with high risk regions and customers has increased enormously for bank over the past five years. As a result it is understandable why banks may choose to scale back their operations to reduce their exposure to fines and civil liability rather than invest in even more sophisticated AML/CTF systems and controls. (Barret, 2015) (Barret, 2015)

Chapter 3- Evidence of de-risking

The earliest example of what can now be called “de-risking” is found in the FT trader in July 2009. The article discusses a fine issued by the National Futures Association against  I-Trade for poor anti-money laundering controls and the subsequent sales of its FX accounts a week later (FX Trader Magazine, 2009).  In the article, there is an implicit assumption that the fine affected the firm’s choice to close its FX business. The use of the term de-risking has since grown to the extent that during the first half of 2015 there were over 270 articles published discussing the topic.

One of the issues with de-risking is that it has been hard to quantify its cumulative effect. There has been a lot written about the individual cases in the press but as the director of the Financial Crime Enforcement network noted in a speech in 2014 “we do not yet know how widespread it is, and we are still working to gauge the impact” (Calvery, 2014).

In the US, Operation Choke Point was a programme run by the US department of Justice specifically to investigate banks that had higher risk customers. It was launched with a specific focus on detecting fraud, but was expanded to include other high risk activities relating to money laundering and terrorist financing. Banks were required to investigate their customers and were encouraged to close high risk accounts or face regulatory sanctions. Concurrently the FDIC issued a list of high risk business types and encouraged banks to be vigilant when offering services to these industries. This has caused much controversy and some argue has further encouraged “de-risking” in America. Included on this list are money services businesses, home-based charities, cash intensive businesses and industries that might cause reputational harm. (U.S. Department of the Treasury, 2015) One of the most high profile outcomes of this operation has been the closing of many accounts of adult entertainers across the US having been included on the FDIC list of high-risk activities.

**Charities**

Following Operation Choke Point there were several reports of accounts being closed for charities across the US (Adely, 2014).These charities had their accounts closed at short notice without explanation which restricted their ability to send aid abroad. Similarly in the UK a survey taken in 2014 found that 61.4% of charities indicated that banks had become more cautious when dealing with them requested additional information. Studies have that reported that charities faced “increasing restrictions on their access to financial services” as a result of international regulatory standards. This has had a particular impact on organisations providing aid across the Middle East and charities operating in areas that are subject to sanctions. (Norton Rose Fulbright, 2015). Charities and NGOs suffer from both operating in higher risk jurisdictions and being less profitable banking clients. As a result NGO accounts are often only screened electronically and have not benefitted from the critical review of risk management staff (Metcalfe-Hough, Keatinge, & Pantuliano, 2015)

British Muslim charities claim to have been disproportionately affected by de-risking. (Metcalfe-Hough, Keatinge, & Pantuliano, UK humanitarian aid in the age of counter-terrorism: perceptions and reality, 2015) The most tangible example of this has been Islamic relief worldwide, where UBS has prevented it customers from sending donations to the charities accounts (Metcalfe-Hough, Keatinge, & Pantuliano, 2015) JP Morgan has been involved in several high profile cases after closing the accounts of businesses, charities and students. Many have claimed that the accounts were closed on the basis of the individuals having Muslim sounding names (Thayer, 2014)  these cases raise questions about whether the bank’s actions amount to discrimination.

Some have claimed that there has been a growing “Islamaphobia” in banking where Muslim charities, groups and individuals have found it more difficult to access product or services and/or have been asked to provide increasing amounts of personal information (Keatinge, 2014).

After the fines it received in 2012 HSBC conducted a global review of its banking relationships and as a result closed the accounts of higher risk clients (Green, 2014) Following this review in 2014 HSBC was accused of discrimination against Muslim groups for closing the accounts of several high profile Muslim organisations. The Finsbury Park Mosque, Ummanah welfare trust and the Cordoba Fountain were told that they no longer fitted the bank's “risk appetite”. HSBC also closed the bank accounts of the Cordoba foundation’s Chief Executive's wife and children. The Ummanah Welfare Trust which provided emergency aid in Syria had its bank account closed by HSBC and had also had it bank accounts closed by Barclays in 2008. HSBC commented that the account closures were part of a global review in which they had exited business and personal relationships with customers in seventy different countries and was not targeted at Islamic charities.

Similarly the Cage group had its account terminated by Co-op and Barclays after its Director was suspected of having links with terrorism. Even after the charges were cleared and the Treasury confirmed that the Director had no financial restrictions placed on him, the charity’s account was not re-opened. Director of Cage believed this was another example of discrimination against Muslim groups (Ramesh, 2014).

Similarly HHUG a support group for families that had been affected by UK anti-terror legislation had its accounts closed by Lloyds which meant that direct debits paid by the charity's supporters could not be received and the organisation lost a significant amount of revenue.

There are reports of churches, mosques and other religious groups that collect cash donations from their congregations have found it more difficult to access banking. Some have alleged that the closure of bank accounts has curtailed their ability to freely exercise their religion (Tendy, 2015). A survey in the UK showed that other faith based groups had faced similar difficulties in accessing finance and it was their charitable status rather than their links with Islam that had led to their accounts being closed (Metcalfe-Hough, Keatinge, & Pantuliano, 2015). Moreover some groups understood that their accounts had been closed as a result of their links with high risk jurisdictions and have worked actively with the BBA and their banks to ensure that the banks understand their business and how they manage their money laundering risks.

**Correspondence banking**

Similarly there is significant evidence to suggest that correspondent banking has been affected by de-risking with consequences for developing regions. JP Morgan has cut ties with several of its correspondent banking partners in developing countries and since 2013 has not taken on any new correspondent banking relationships (SIBOS, 2014). JP Morgan, HSBC and Citi groups are reported to have each cut correspondent bank service in over 30 jurisdictions (Financial Times, 2015) Standard Chartered and BNP Paribas who hold licenses to clear US dollars have also terminated hundreds of correspondent banking relationships.

The Bank of America has exited its correspondent banking relationship with the Bank of Belize severely limiting international clearing services to the Central American and Caribbean region. The Bank of Belize is the country's largest lender and having lost its corresponding relationship means that it has been unable to process international wire transfers. These now have to be processed through the central bank (Marty, 2015).

BAML has admitted that the reduction in correspondence banking may mean that “certain markets may effectively lose access to clearing services in major currencies.” (Swift, 2014) In Belize the commercial banks have lost access to global clearing services and are now reliant on the central bank. This may be possible in Belize as a smaller country with less than average international trade links. However in many countries the central banks would not have the capacity to clear the volume of international transactions that the commercial banks process. Moreover central banks do not have the same capability to monitor transaction and conduct ‘know your customer’ assessments.

In a recent survey conducted by the BBA, 17 international banks had closed several thousand correspondent banking relationships since 2011. Two banks had terminated up to 20% of their correspondent banking relationships (Walker, 2014). Citi bank have estimated that this has resulted in a $1.6 trillion decline in trade finance services, with significant reduction in Asia ($400bn) and sub-Saharan Africa ($135bn) (Ladany, 2015).

This is supported a survey from the International Council of Commerce that found over 100 banks  had exited corresponding banking relationships due to enhanced AML compliance costs. This survey also found that the middle east and sub-Saharan Africa and small-medium size businesses were most affected by the declines in the correspondent banking (Arnold, 2014).

**Remittances**

Most controversially de-risking has seen the closure of accounts for MSBs who handle the vast majority of global remittances. De-risking has been highly prevalent in this area with many banks exiting all relationships with MSB. In the UK, the Money Transmitters Association estimated that almost 85% of MSBs that process remittances internationally have lost their banking relationships. (Walker, 2014) (The Commonwealth, 2015).

Barclays bank was the last major UK bank to offer services to MSBs. In 2013 it closed 250 MSBs accounts worldwide and withdrew services from 90 UK MSBs accounts.  These accounts helped facilitate the $23.6billion remittances that were set from the UK in 2012 (Attridge, 2015). As a result of these closures many individuals struggled to send remittances back to families abroad. This was particularly acute for Somali communities. Due to the civil war in Somalia the formal banking system had collapsed making MSBs the main source of financing into the country.

$1,3 billion is remitted annual to Somalia and makes up 50% of its Gross National Income. The World Bank estimates that the over 40% of the population (approximately 5 million) rely on remittances from families abroad to meet their basic needs (UK Government, 2015).

In 2013, Dahabshiil the largest remitter to Somalia successfully won an injunction against Barclays for abuse of its dominant position in the market place. It argued that in closing its accounts it was unfairly pushing a competitor out of the market. As a result Dahabshiil had its account re-instated. Later this case was settled privately between the two companies which created a transitional period for the account to be closed so that Dahabshiil could make alternative banking arrangements. However it is worth noting that many other UK banks such as HSBC have also closed accounts of MSBs, so finding an alternative bank that will serve MSBs has become increasingly difficult (Metcalfe-Hough, Keatinge, & Pantuliano, 2015).

The publicity surrounding this case was enough to make the government review of the banking facilities for remittances between the UK and Somalia. As a result of this review the action group on cross border remittances was established in 2014 and has worked with World Bank to develop a “Safe Corridor” to ensure that funds can be moved transparently between the UK and Somalia. This is a clear example of a government initiative to correct for the unintended consequences of enhanced AML/CTF legislation.

Similar problems have been experienced in the US where each week $1bn of remittances are sent abroad (Arnold, 2014). Due to the increased regulation only the Merchant Bank of California still serve MSBs that operate in Somalia (Paul, 2014). According to Oxfam America this has meant that 80% of US remittances to Somalia have been stopped. The last remaining banks that are willing to provide accounts to MSBs do not have the capacity to provide banking to the other MSBs that have had their accounts closed. [64]This has stopped flow of remittances, increased the cost of sending remittances and reduced competition in the sector.

Comments from the US Treasury suggest that some US banks had chosen not to provide service to MSBs “regardless of [AML] risk” they actually posed (U.S. Department of the Treasury, 2015). This was supported by FinCEN which noted that banks were “indiscriminately terminating accounts of money transmitters” (FinCEN, 2014). These are clear examples of a disproportionate de-risking. When banks are not considering the risks that their customers pose but chose to exit the relationship as the cost of individual assessments are too high.

Remittance businesses have also suffered in Australia and New Zealand. Australia’s remittances are estimated to be $A30billion annually. Following Australian regulators ASIC enforcement action against 2 MSBs for links with terrorist financing, three out of four of the large commercial bank have closed the MSB accounts (Pandey, 2014).

This has also been legal action in Australia when Westpac the last remaining bank to offer service the accounts of the MSB’s planned to close their 5,5000 MSBs accounts. 24 MSBs have since successfully filed a class action against Westpac to extend the provision of banking services for a transitional period. However Westpac’s withdrawal from the MSB sector now mean that it is no longer possible to send remittances to Somalia. The knock on implications has meant that the cost sending of remittances has already increased by 2 percentage points. Here there is a potential conflict of interest as the large banks also offer international currency transactions however the cost of their fees in Australia is historically twice as high as those charged by the money services businesses (Singh, 2014).

**Individuals**

**Politically Exposed Persons**

There is also evidence to suggest that banks have reduced their exposure to PEPs. JP Morgan faced criticism when it closed the account of José Ocampo, the former foreign minister in Columbia as the bank reduced its exposure to foreign diplomats. This was part of a review that was estimated to have affected 3500 private wealth customers including former diplomats and UN staff. (O'Brien, 2014)

HSBC, after it was fined in 2012, wrote to over 40 consulates and embassies in the UK terminating their banking relationships. This included diplomats from the Vatican, Benin and Papa New Guinea who reported difficulties finding other banks (RT, 2014) This was part of the so called six filter assessment that HSBC had rolled out over their client base to determine where it would continue to do business. Originally HSBC used a 5 filters (international connectivity, economic development, profitability, cost efficiency, liquidity) to decide whether to continue a relationship (Hart, 2013). HSBC later added a sixth filter to detect countries, clients and relationships that could cause issues from a regulatory or ethical perspective as well as investing $700million to improve the ‘know your customer’ checks. (Ready-Made Investment Digest, 2014)

In the UK an FSA thematic review found ¾ of the banks they had inspected were not effectively managing their relationships with PEPs. They found that banks were not correctly identifying individuals as PEP and challenging them on their sources of income and account usage. (Financial Conduct Authority, 2013) Given the widespread poor practice that the regulators found it was not surprising that several UK banks decided to close the accounts of PEPs in the UK. The issue was raised in the House of Lords when domestic peers were included in the definition of PEP. Several family members of the House of Lords had been unable to open accounts, change the names on accounts, access accounts abroad, use ATMs or enact a power of attorney. However overall these cases seem to be fairly low with the Financial Ombudsman only receiving 80/50,000 complaints on the subject of the treatment of PEPs. This a small percentage of the 150,000 PEP that are estimated to reside in the UK (House of Lords, 2014) FATF specifically clarified in a statement that refusing a business relationship because of a person is a PEP is contrary to the spirit of the FATF recommendations and urged banks to take a more risk-based approach. (Financial Action Task Force, 2012)

**Ethnic minorities**

Moreover the BBC reported that hundreds of individuals from ethnic minority background had had their accounts closed at short notice with little explanation from the banks (Howard, 2013).There are specific examples of individuals from Iranian backgrounds having had their accounts closed or suspended. A high profile case of this was Iraj Hashi an eminent Iranian economics professor and his wife had their accounts closed by NatWest despite have 40 years of good banking records. Natwest confirmed that they would never close a client’s account based on their nationality. However there have also been other reports individuals of Iranian heritage having their account closed. (Rawlinson, Lewis, Field, Howsam, Collison, & Allan, 2013)The Iranian national television channel had its accounts frozen by NatWest in 2011 without explanation. Similarly Justice for Iran, a group that documents human rights violations in Iran was unable to open a bank account in the UK as they had Iran in their company name (Dehghan, 2014).

Barclays as part of its on-going review of risk in the Middle East closed over 500 account in the United Arab Emirates to comply with local regulatory standards. On asking why the accounts had been closed one individual had been told explicitly it was because he was Iranian. More generally Barclays have retracted business in the region closing a number of branches and focusing on investment banking and wealth management.

There is an on-going class action against three large high street banks for discrimination against 20 of their Iranian clients. In this case the banks gave evidence to the courts stating that these accounts been linked with a business that had made payments to Iran. Whilst this case is on-going RBS has suspended the closure of the accounts pending the outcome of the trial.

In the US several Iranian college students had their accounts suspended and launched a Facebook campaign in protest (Moore E. , 2013). The Bank of Hawaii has been similarly sued for discrimination against Iranian Americans (The Isaac Brock Society, 2014).  These incidents have led the National Iranian Council to state that US banks are discriminating against Iranian nationals Similar reports of Iranians account closures have been reported in Canada where 14 account from various banks  were reported to have been closed to students of Iranian background in Montreal at short notice. (Bernstien, 2014)

In Minneapolis there are reports that from 2012-2013 that TCF bank closed the accounts of individuals with Muslim sounding names despite having clean banking records and never sending money abroad (Harb, 2015) One former bank manager has reported that a high street bank would regularly refuse to open bank account for potential customer if they came from East Timor, Sudan, Iran or Pakistan. These were all countries that were rated as high risk. He went on to remark that accounts would also be closed if existing customers were discovered to hold passports from these countries.

There are also reports of a number of Syrian students having had their accounts closed by HSBC as a result of increased regulatory attention on countries on the sanctions lists. HSBC have said that they are discontinuing relationships with customers from listed sanction regimes where they have insufficient information to fulfil the know you customer requirements (Hunter, 2013). Individuals from Zimbabwe have also found it difficult to keep bank account at HSBC (News Day, 2013).

This chapter has evaluated the available evidence of the extent to which de-risking has taken place. De-risking seems to have intensified from 2012-2015 with growing concerns about discrimination in banking. We have seen that this de-risking in not just a British phenomenon but has also occurred in in Canada, the US, Australia and New Zealand. Whilst these accounts are anecdotal there seems to be similar de-risking approached developed across these countries. This has had profound affects for both individuals and businesses as correspondent banking relationships and money service businesses have had their accounts closed. Most concerning has been the impact of de-risking on remittance payments which explored further in Chapter 4.

Chapter 4 Consequences of de-risking

We have seen in the previous chapter whilst it has been difficult to estimate the scale of de-risking there is a significant amount of anecdotal evidence that suggests that it has been fairly widespread. Moreover it is clear that the large banks are taking a more cautious approach to risk in the light of regulatory focus on AML and TF controls. We have seen how the systematic review of existing client books has result the termination of “higher risk account” across the world and that this has caused significant problems for certain groups of customers. The next chapter will look at the unintended consequences of the termination of these accounts. Whilst a more vigilant approach to AML and CTF reduces the risk in the formal banking system, de-risking displaces risk and had several unintended consequences.

**Unbanked parts of the world**

Concerns about de-risking have become so strong that they have made it to the agenda at the G20. Mark Carney raised concerns that de-risking was leaving “parts of the world un-banked or less actively banked”. These concerns were echoed by Sir Sherard Cowper Coles a senior adviser at HSBC who said that de-risking could leave parts of the world “cut off from the global banking sector”. He went on to comment “there may be a public interest benefit in these withdrawals, there may also be cost” (Arnold, 2014) This reminded us of the tension between wanting to reduce the risk that financial system is used to facilitate crime and terrorism but also wanting to ensure that we do not increase financial exclusion.

The sharp decline in global correspondent banking has left some developing countries without access to the international financial community. Mark Carney has warned that this could lead to financial abandonment for certain countries (Carney & Badre, 2015). We have already seen that in Belize the decline in correspondence banking has meant that funds have had to be cleared through the central bank. This requires the public central bank to take over the monitoring of customers and financial transactions. Economist have warned that most central banks in developing nations are not equipped to conduct the same standards of customer due diligence as the large international banks. Moreover several central banks would struggle to process the same volume of transactions as the commercial banks. Moving compliance and oversight of financial transactions in developing countries to the central banks would reduce the quality of AML/CTF controls and increase the risk of the financial systems being misused. It also would require a significant investment from the central banks to upgrade their current facilities to meet international standards. Arguably the cost of monitoring transactions for suspicious activity would then fall back to public administration. However the ability of central banks to undertake detailed customer due diligence would be extremely expensive. In developing nations this public money arguably could be better spent on other initiatives.

Moreover the G20 have significant concerns about the impact of de-risking on MSBs and the unintended consequences for remittances to developing nations. As MSB struggling to access to clearing banks the cost of sending remittances is likely to increase. This has already been seen in Somalia. This is at odds with the G20 goal of reducing the average global cost of remittances to developing countries (G20, 2014)

The volumes of remittances that are able to be transmitted are also likely to fall (Keatinge, 2014). Many high risk AML/CTF countries are extremely dependant on the remittances. In Tajikistan for example remittances constitute 42% of the national GDP. In Lebanon (which is considered a high risk terrorist jurisdiction), remittances make up 17% of the national GDP. As a result of de-risking these incomes are likely to fall and have widespread economic consequences for individual’s dependant remittances as source of income.

Many considered that the US banking system is now “hyper-vigilant” when it comes to de-risking. This is of particular concern to global remittances as the US is the world's remitter and send $123 billion abroad each year. Remittances have been a driver of sustainable growth in many countries and the G20 are concerned that de-banking will cut flow of remittances significantly, holding back and potentially shrinking developing economies. This could have unintended consequences for the financial stability of areas dependant of remittances (Keatinge, 2014) and de-stabilise areas already vulnerable to terrorism and financial crime (Cull, 2014).

Moreover if the cost of sending remittances through money transfer businesses increases and becomes more difficult, many will look to alternative informal solutions in the shadow economy to send remittances. Networks such as Hawalas are often used to transmit remittances cheaply and circumnavigate exchange controls but are also used to finance illegal activities. The enhanced used of underground banking system will mean that more transactions will pass unrecorded and unmonitored. This means transparency and visibility will be reduced and the transactions that were previously monitored by the banks able to detect and report suspicious activity reports will be processed illegally. In this sense whilst the risk that the formal banking is miss-used may have been decreased, the risk has in essence just been displaced. This risk has been identified by FAFT that state “de-risking” could introduce risk and opacity to the global financial system by forcing certain entities and persons into less regulated or unregulated channels.

De-risking poses other direct cost for developing countries dependant on international aid. It has become more difficult for charities working in higher risk jurisdictions to process transactions, collect and distribute funding.  There are several examples of this causing delays in aid reaching beneficiary zones and causing projects to collapse. In some cases large donations have had to be returned as they could not be cleared in time, other donations have been blocked completely (Keatinge, 2014). The cost for some charities of processing transactions has increased as they have had to route funds through several different countries. All of these issues take away available funding from aid programmes in vulnerable areas of the world. In the UK, the public campaign that raised £23 million in emergency funding for Syria, found it difficult to move the aid into the country due to the international regulations and sanctions list. A number of Syrian banks had had their assets frozen and many international banks have pulled their services out of a region making it difficult to transfer funds into the region (BBA, 2013). The BBA has worked with the disaster emergency committee to produce a guide to helps charities operating in high risk regions. This is a good example of public/ private collaboration to tackle the unintended consequences of de-risking. As it becomes more difficult to move legitimate funding into the region there is the risk that charities also look to alternative methods of financing such as couriering cash across borders (Barret, 2015) This again reduces transparency and increases the opportunities for charitable funds to be misappropriated.

In the UK the FCA has commented on the adverse effects of de-risking and warns that an overly cautious approach to AML/CTF is a damaging the growth in certain financial markets as well as limiting consumer choice in the domestic market. (FCA, 2015) .On one hand banks choosing to move out of certain market segments could increase competition in banking and allow for new opportunities for smaller banks and new entrants. However many of these smaller operators have not invested in automated screen capabilities and have less stringent AML/CTF controls in place (McKendry, 2014). Again this has not reduced the amount of risk in the banking sector but displaced it to financial institutions that are worse place to identify it.

The obvious consequence of de-risking is the service disruption for legitimate financial customers from enhanced due diligence and account screening.  FATF have warned that an overzealous application of their rules could exclude legitimate business to be excluded from the financial sector. This could have significant implications for the economic recovery in the UK

**Chapter 5 –De-risking and Financial Inclusion**

One of the largest unintended consequences of de-risking has been the impact on financial inclusion. Financial exclusion is defined as “the inability, difficulty or reluctance of particular groups to access mainstream financial services’ [109] In chapter 3 this essay looked at anecdotes of groups of customers that had had their banking relationships terminated and or had been prevented from accessing financial services.

In the UK an FCA report  commented that “ a bank with previously identified AML failings had closed over 200 higher risk relationships, of which only two appeared to involve suspicious activity” (Fiancial Action Taskforce Plenary, 2014). This is a clear example of the disproportionate de-risking, where the accounts of 198 people have been closed without any indication of suspicious activity. This is supported by the comments of the chairman of HSBC who was reported to have said that an “an observable and growing danger of disproportionate risk aversion creeping into decision-making” (Arnold, 2014).

The OCC in the US has clarified that it does not “encourage banks to engage in the termination of entire categories of customer accounts without regard to the risks presented by an individual customer or the bank’s ability to manage the risk”. That is customer risks should be evaluated on an individual basis and that effective risk management should not translate into wholesale de-risking.

Similarly the FCA has stated that de-risking is a commercial decision for banks but their decisions should not unduly impede legitimate access to financial services or financial inclusion. The FCA has specified that where firms believe they cannot manage a customer’s financial crime risk effectively it should not maintain or enter that business relationship but expects that “there should be relatively few cases where it is necessary to decline business relationships because of anti-money laundering requirements”.

The FCA has also gone further and said “firms need to access the social cost of withdrawing from products and areas as part of a de-risking process against the wider policy objective of financial inclusion” (Financial Conduct Authority, 2014).

Here the FCA is expecting banks to consider the social cost of their business decisions. As commercial entities there is a question as to have far banks should have to consider the social cost of their actions. The extent to which financial inclusion is considered a responsibility for bank is dependent on the public opinion and varies amongst countries.

The European Commission has stated that all European citizens should be able to access and use a basic payments account. Providers of basic bank accounts are expected by the commission to write to their customers to explain why they have been unable to open except for reasons of public security. The commission also requires that a competent authority monitors the implementation of its recommendations and provides a resolution mechanism for disputes surrounding basic bank accounts.

In Belgium the 25 major banks volunteered to offer every citizen a bank account that provides withdrawals, transfers and bank statements. This was based on grounds that “normal life is impossible without an account”[101] After finding that money laundering regulations “excluded people with administrative status issues” Belgium concluded that the voluntary code had failed to increase levels of financial inclusion sufficiently.

Consequently Belgium adopted a law requiring the provision of basic banking services for all consumers for less than 12 euros. This law is overseen by a body that reviews all account closures and reasons for denial of service to customers. It can also settle disputes for unjustified closures and issue fines to non-compliant banks (Bayot, Disneur, & Kempson, 2014). Customers also have recourse to take legal action against termination of bank account closures.

In Belgium the law was supplemented by a compensatory fund for any bank that had to take on a disproportionate amount of unprofitable clients. To date this fund has not been used. In Belgium banking is assumed to be a public good and the cost of it is provision is covered by the private sector only to the extent that it profitable for them to do so. After this point the Belgian government has committed to subsidise the cost of banking to unbanked individuals.

In the Netherlands a voluntary code of conduct is in place between banks to offer basic banking services to citizens over the age of 18. Under the code bank accounts can only be terminated in “serious circumstances such as abuse” after giving 30 days’ notice. Accounts are available to everyone that can validate their identity (European Commission, 2008). This is also supported by a monitoring by the Dutch Banking authority.

In Canada a similar outcome is achieved through legislation. The access to basic banking regulation gives Canadian banks an obligation to provide basic banking services to its customers (Canada, 2015). Banks can refuse to open accounts only if it has, “reasonable grounds to suspect that the account will be used for illegal activities”. However this regulation gives no instructions about the responsibilities of banks when they are considering closing accounts. No successful cases have been brought against banks for the non-provision of services or the termination of existing relationships. The regulation also does not cover commercial accounts and only offers protection for retail customers.

In a significant Canadian case, (RCG Forex Service Corp. v. HSBC Bank Canada, 2011)HSBC closed Forex’s account as it was considered a higher risk customer. HSBC wished to close the account so that it could reduce its exposure to regulatory risk (RCG Forex Service Corp. v. HSBC Bank Canada, 2011) The judge ruled that HSBC was entitled to do so as the terms and conditions specified that HSBC has the right to terminate the account without notice. This is a clear case of HSBC de-risking its client base even when it did not have grounds to suspect that the account was being misused (RCG Forex Service Corp. v. HSBC Bank Canada, 2011). In this case HSBC did not have to demonstrate that it had closed the account as a result of “sound commercial decision” due to the terms and conditions in its contract.

All the tested cases in Canada have supported a bank's right to terminate business relationships. The courts have ruled that bank accounts are subject to contractual law and as such the terms and conditions of the account are the only relevant factor to consider. This has included the bank's right to terminate accounts without notice if the terms and conditions provide for this (McMillan, 2011)] It is not expected that banks continue to do business with clients that they no longer wish do business with (McMillan, 2011)

**UK Financial Inclusion**

The UK scores well internationally on measures of financial inclusion, such that 98.9% of all adult older than 15 have access to a bank account. This is significantly higher than in the US where 93.58% of adults have access to a bank account. You might have expected concentrated de-risking from 2011-2014 would have increasing the number of individuals that are financially excluded. However in the UK financial inclusion has increased since 2011 when only 97% of adults had access to a bank account. This suggests that de-risking has not had widespread impact on personal current accounts and has not lead to a net general increase in financial exclusion in

the UK  (World Bank, 2014).

In 2005 there were 3 million unbanked individuals (Woolhouse, 2014). In 2014 this had fallen to 1.87 million adults. Of these 1.87 million only 1 million wanted access to a bank account. This suggests that a maximum of 1 million individuals in the UK are financially excluded (Mitton, 2008). There are many drivers of financial exclusion and de-risking alone will not account for the total amount of people that are financially excluded, however it may have had a disproportionately concentrated effect on particular communities and businesses.

Before de-risking was first reported in 2009, ethnic minorities in the UK were considered to be particularly vulnerable to financial exclusion (Mitton, 2008). 62% of individuals that were unbanked in 2005 were of Asian or Black, in this group Afro-Caribbean, Bangladeshi and Pakistani were most unlikely to be financially excluded (Kempson & Collard , 2012) Women of ethnic minorities in the UK were more likely to be financially excluded than their male counterparts (Toynbee Hall, 2008). A European wide study showed that migrant populations were more likely to be-unbanked and that financial exclusion in the UK was closely linked with social exclusion. (European Commission, 2008)

As a result in the UK a voluntary code was established by the Banking Code Standards Board, a predecessor to the Financial Conduct Authority. The 2005 code of conduct details the standards of the conduct that are expected for banks that provide basic bank accounts. (Toynbee Hall, 2008) However this was a voluntary code, and contained no direct requirement for banks to provide basic bank accounts as they are generally loss making.

In 2003 Universal banking was rolled out across the UK which meant that pensioners and benefit claimants would have to open the basic bank account to receive state payments. This meant from 2003-2008 an average of 50,000 accounts were opened a month. The closure of basic accounts without reason at short notice was fairly common in 2008 and disproportionately affected individuals that did not speak English as a first language and were not British citizens. This suggests that even before banks started to review their customer relationships 2012, basic bank account customers from minority groups were more likely to involuntarily have their accounts closed.

Similarly in 2014 the government announced a basic bank account agreement which required providers to offer fee-free bank accounts to customers that were in-eligible for other accounts. This is a voluntary agreement that has been subscribed to by 90% of UK banks and will come into operation by the end of 2015 (UK Government, 2014). Banks can refuse to offer customers accounts if they believe that they will be used for illegal activities or it might break applicable laws or regulations. Providers can close a basic bank account if it “is concerned that a customer has or will use the account unlawfully”. The provision and closure of basic bank accounts will be monitored by the Treasury (UK Government, 2014).

In the UK as in Canada account closures are still considered a commercial decision. Firms are under no obligation to continue to service accounts if they do not believe that it is “appropriate to do so” (Financial Ombudsman Service, 2005) The new free-fee banking agreement will not change this as it is a voluntary code of conduct, however the fact that HMT will be reviewing the number of basic bank accounts closures will increase transparency around account closures. Bank are expected to be able demonstrate that they closed the accounts as they were concerned that customers would use the account unlawfully.  It is important to note that this review will not require the submission of data for other types of personal current accounts or business accounts.

For all account closures the Financial Ombudsman (FOS) recommends that accounts should not be closed for “un-proper reasons” such as unfair bias or discrimination (Financial Ombudsman Service, 2004). They found in favour of a Somali individual who having presented his passport was refused an account due to the “problems with the current terrorist situation”. He was offered £750 in compensation for inconvenience and distress caused. (Financial Ombudsman Service, 2004). This is an interesting case as Somalia is considered a high risk AML jurisdiction. It is not clear what grounds the FOS decided the bank actions were discriminatory, or whether this case involved a basic bank account. However under the basic bank account agreement banks would have to have concerns that the customer would use the account unlawfully to refuse an application. This is higher standard of proof than would be required for the refusal of general personal current accounts where it is still considered a commercial decision. It also offers insight into the level of compensation deemed appropriate for racial discrimination when opening accounts.

To date no UK case law tests whether refusing to open an account or exit existing relationships for “higher risk” customers is considered discriminatory. The case that offers the most insight is Shah vs HSBC 2010. HSBC filed a suspicious activity report against Shah and refused to process his transactions as they believed they were connected to money laundering. They subsequently asked him to close his HSBC account. The original hearing found in HSBC’s favour as the bank had acted in good faith and had the right due to a clause in it terms and conditions to act without Mr Shah's consent. The appeal hearing later stated that the bank was in an “unenviable position” where they risked being prosecuted for breaching the Proceeds of Crime Act if they had continued to process a transaction that was considered suspicious. They also risked being sued by customers for any delay and damages caused by refusing to process the funds. This case was crucial in determining the level of evidence that a bank needs in order to act against a customer's wishes

The case established that a bank “must think there is a possibility, which is more than fanciful, that the relevant facts exist. A vague feeling of unease would not suffice. But the statute does not require the suspicion to be ‘clear’ or ‘firmly grounded and targeted on specific facts’ or based on ‘reasonable grounds’”. Banks must only be able to evidence the fact that they had suspicions at the time and that these suspicious were sufficiently documented.

We have seen that banks have closed accounts not on the suspicion that the account have been misused but because they are considered high risk. Moreover we have seen that in Canada the courts have ruled that banks have the right to end business relationships without reason or explanation as long as it is covered in the terms and conditions even if customers are not considered to be higher risk.

This is supported by the New Zealand ombudsman who stated that a fundamental part of a banking relationship is the ability of “either party to end it at any time”.

In the US a plaintiff brought a discrimination case against JP Morgan for the closure of his accounts (KHUDHIR V. JP MORGAN CHASE BANK, 2014). A court in Michigan found that there was insufficient factual evidence to demonstrate that the bank “intentionally interfered with or impaired the plaintiff's contractual right on the basis of race”. This case concluded that the plaintiff had to do more than “guess” at why his account had been closed and needed evidence to show that his account had been closed due to race. (KHUDHIR V. JP MORGAN CHASE BANK, 2014)

However a court of appeal has overturned a decision by the District Court of Eastern Michigan who dismissed claims that Huntingdon bank unlawfully discriminated against 25 Arab Americans who had their account closed without due reason. The attorney heard from 150 Arab Americans who had also had their accounts closed. The court decided that the lack of “alternative explanation for the account closures” led to the plausible inference that the plaintiffs faced unlawful discrimination (EL-HALLANI v HUNTINGTON NATIONAL BANK, 2014) This was compounded by evidence from a former employee of the bank who testified that a large number of customers had had their accounts closed that were of middle eastern descent who had previously had had a good working relationship with the bank. (Harb, 2015)

These two cases require different standards of evidence to determine whether the closure of account was discriminatory. In (KHUDHIR V. JP MORGAN CHASE BANK, 2014) the responsibility for providing evidence that the account had been closed because of racial discrimination rested with the plaintiff. In (EL-HALLANI v HUNTINGTON NATIONAL BANK, 2014) the bank was unable to demonstrate that the account closures were not racially motivated and now face trial for discrimination. This is a reverse burden of proof.

Banks have an obligation not to “tip off” individuals when they have reported suspicious activity to an authority. As a result customers are often not given a reason for their account closures and bank would be unable to disclose why that had chosen to close accounts. As a result a customer would find it difficult collect the level of evidence required in (KHUDHIR V. JP MORGAN CHASE BANK, 2014)to prove that discrimination had taken place. Similarly a bank is often unable to disclose why they have chosen to close accounts and may struggle to evidence the reasons for account closures as required in (EL-HALLANI v HUNTINGTON NATIONAL BANK, 2014)

Banks are under no general obligation to give reasons for account closures. As Shah vs HSBC demonstrates the level of evidence that a bank has to have to suspect that an account is being misused and act against a client's instructions is very low. The bank only has to think that the relevant facts exist not evidence that they do. As a result it is unlikely that the cases being brought against  3 high street banks for discrimination against their Iranian clients is unlikely to succeed and will depend heavily on the terms and conditions of the account and the relevant contractual law. However if the banks are required to prove that the closures were not racially motivated they may struggle to make public sufficient evidence for the jury to conclude that their action were not discriminatory. This was similar to the cases against Arab bank where its inability to make evidence public due to banking secrecy laws meant that the jury were allowed to conclude that it was guilty.

Regardless of whether the banks have acted in a discriminatory manner the difficulties that certain national group such as Iranian and Syrians have faced in opening and maintain bank account feeds a narrative of an Islamaphobia in the banking sector. Importantly, when individuals of these nationalities have not be given clear reasons for the closure of their accounts allegations of discrimination. In their study Maxwell demonstrates that instances of perceived discrimination against Muslims reduces British Muslims identification with the UK and increases an individual susceptibility to radicalisation (Maxwell, 2006). Indirectly de-risking may increase perceived discrimination and may contribute to a narrative that fosters radicalisation, indirectly increasing the threat of terrorism to the UK.

**Banking as a public utility**

Over the past ten years support for financial inclusion initiatives has grown in the UK and Europe. As a result levels of financial inclusion have increased significantly as banks through voluntary agreements have helped to roll out fee-free basic bank accounts. This is important as having a bank account is increasingly seen as a gateway to transactions in an increasingly digital economy. There are now very few jobs that still pay salaries in cash and as a result a bank account is increasingly seen as a “condition of employment” Declining cash usage has meant that the cost of cash transactions have increased and often bills and utilities are discounted when paid by direct debit.  However providing universal access to unbanked customers comes at a cost, one that at the moment, the banks in the UK have been willing to carry.

As the use of basic bank accounts has increased, banks have reduced services to “higher risk” customers to avoid regulatory penalties and indirect liability. As the reasons for account closures are not public some question whether the bank's have used higher regulatory requirements as a “fig leaf” for closing unprofitable accounts. In fact Martin Wheatley the former CEO of the FCA questioned whether banks were using regulatory sanctions as an “excuse to avoid customers”. (Jones, 2015)

Shah vs HSBC 2010 demonstrates the importance of maintaining detailed records and reporting suspicious activity quickly to avoid being sued by customers for damages in delayed payments. This requires increased investments in screening and reporting technologies as well as on-going staff training costs.

With advanced screening technology banks are able to detect high risk customers before they may appear on any official sanctions lists. In these cases it is much of cheaper for the banks to close the existing banking relationships than for the banks to conduct further investigations into these individuals. It is not clear what is expected from a financial institution if they are detecting potential money launderers and terrorist financing before law enforcement agencies.

How far should the banks have to investigate the alerts generated by these electronic detection systems for customers that are not on the officially designated sanctions list before deciding to close an account. According to the limited case law provided by Shah vs HSBC 2010 it would be sufficient for a bank to be able to demonstrate that it has suspicions about an account not that they were based on reasonable grounds. Acting on a high risk scoring from a system design to detect high risk accounts would probably be sufficient to demonstrate the bank has suspicions about the account and provide sufficient reason for a closure

Banks currently do not have a legal responsibility to investigate further and ensure that they are not unduly restricting banking access to individuals who are caught inadvertently by the screening systems. (Metcalfe-Hough, Keatinge, & Pantuliano, 2015)This would require a change in regulatory law or for a new precedent to be set in case law. It would take concerted public pressure to create further changes in AML/CTF regulation as so many of the standards are set at an international level. Similarly it would require a case to prove that de-risking higher risk customer was discriminatory for banks to have to change their de-risking programmes.

Chapter 6 - Policy options

As a society we have to weigh the cost of potential financial exclusion against the need to protect our financial systems and tackle organised crime. We have to establish what cost we are willing to pay ensure that innocent individuals are not financial excluded by de-risking.

At the moment this balance is difficult to determine as the extent of de-risking is currently unknown. From media reports we know that at least several thousand accounts have been closed. From studies of financial exclusion we know that there are a million individuals that want and can't currently access bank accounts. Somewhere between several thousand and a million customers will have been affected by de-risking in the UK and there is anecdotal evidence to suggest that this will disproportionately affect member of ethnic minorities. This upper limit of a million is likely to be reduced as fee-free basic banks account is rolled out across the UK at the end of 2015.

Furthermore they are limited ways of publically quantifying the benefits that monitoring, closing accounts and freezing the assets of criminals will have provided. This information is often classified and not-released publically.  As such it is difficult to determine the extent to which banks have disproportionately de-risked and how strongly there is a case for action.

However we know that de-risking has attracted a strong international regulatory response and has been described as the “antithesis of an appropriate risk-based approach”. FATF have stated that banks should only terminate relationships, “where the money-laundering and terrorist-financing risks cannot be mitigated.” It condones the “wholesale cutting loose of entire classes of customer, without taking into account, seriously and comprehensively, risk or risk mitigation measures for individual customers within a particular sector.” (Financial Action Task Force, 2012)

In the UK the FCA has stated that effective risk management does not require wholesale de-risking. The FCA has recognised that ultimately a bank's choice of client is a commercial decision but has warned that it may enforce against banks that are disproportionately de-risking without regards to consumer protection and competition issues.

If regulators started to issue significant fines for disproportionate de-risking, banks would have an incentive to ensure that their commercial decision did not dis-proportionally affect certain groups. However given the size of the fines that have been issued for breaches of AML/CTF regulation any enforcement action would have to be very significant to act as a credible deterrent to de-risking. It would also be very difficult to bring successful cases against banks for de-risking when there is no formal legal requirement in the UK for banks to provide universal banking services. The new Treasury initiative to provide fee-free basic bank accounts has been established purely as a voluntary arrangement and could not be enforced against.

If de-risking is ultimately a commercial decision the question then remains who has responsibility for addressing its unintended consequences. To date there have been several voluntary organisations that have started to address the issues associated with de-risking.

The Wolfberg group is a private association of 11 large international banks that meets to collectively address AML/CTF issues. It has established its own best principles for tackling AML/CTF issues and led the debate on counter terrorist financing after 9/11. The group holds regular conferences under Chatham house rules to allow space for informal dialogue between banks, regulators and civil society groups. It is an industry driven and voluntary initiative that has helped to improve global standards of anti-money laundering. Currently the Wolfsberg group is working with the BBA to lead a joint project on the impact of de-risking that will report to G20 finance ministers.

Following the G20 summit in Brisbane the Remittance Action Plan provided a renewed focus of de-risking. Consequently the World Bank has launched a global survey to establish the extent to which de-risking is occurring around the world. This survey had a particular focus on the effect of de-risking on the global remittances market and submissions were due for collection by the end of June 2015. This survey will establish in greater detail the extent to which the anecdotes that we have reviewed in this essay are representative of the de-risking. (Cirasino, 2015)

In the charity sector, the global centre on cooperative security has started an international study in conjunction with Oxfam that looks at how de-risking has affected access to financial services for vulnerable people such as women, youth and marginalised communities. (Global Center on Cooperative Security, 2015)

These efforts represent a concerted international co-operation between the public and private sector to better understand the consequences of de-risking. Where the responsibility for addressing the consequences of de-risking, is currently unclear. The private sector in the UK has already invested significantly in developing enhanced AML systems and controls and made commitments to support those that are currently un-banked. They have not however made a commitment to ensure that their de-risking is done in a proportionate way and have not had to report publicly on the extent of de-risking.

Having greater public transparency around this issue would significantly improve the public debate around the appropriate limits of a bank's public function. From the end of 2015 banks will have to report to the Treasury the number of basic bank accounts that they close each year. This commitment could easily be extended to include the closure of other bank accounts. This would enable the government to more easily keep track of the effect of de-risking to judge whether further intervention in required.

So far in the UK there has been good co-operation between the public and private sector to tackle some of the un-intended consequences of de-risking. Through collaborative initiatives remittance payments have been re-established through a “safe corridor” to Somalia. The BBA has worked with the Charity Commission to issues a guide to reduce the impact of de-risking on the charitable sector. The Wolfberg group has provided important contributions to international money laundering debate. Whilst the Joint Money Laundering Steering Group (JMLSG) have issued guidance that has been approved by the Treasury to help MSBs engage more constructively with banks.

Such voluntary initiatives should be celebrated; however it has taken a significant of public pressure to inspire action in this area. Going forward there is a question of where responsibility lies for the issue. In the UK the BBA, the JMLSG, the Wolfberg group, the PRA, the FCA, the Financial Inclusion commission, the Government and the Competition and Markets Authority are key stakeholders to the debate. There is also a role for third sector action groups and legal representatives to challenge the decision being made by the banks and for charities to collect information about how de-risking to affecting already vulnerable and marginalised groups.

Internationally Mark Carney has called for greater collaboration between regulators to tackle the issues caused by de-risking. To be effective there will have to be strong coordination between these different stakeholders. This coordination role could perhaps be played by the Banking Standards Board. This is a new body that has been established to help restore the trust in the financial sector and promote high standards in banking. They have a mandate to promote collective action and will monitor conduct in all of the large UK banks. As an independent body it could coordinate action between these different stakeholders and monitor the levels of de-risking. Again this solution would be made on a voluntary basis and would require the on-going good will of the banks.

In other countries such Belgium basic bank account have been subsidised by a compensatory fund for banks that provided a disproportionate share of the un-profitable basic bank accounts. If further intervention was necessary a similar fund could be established for banks that retained businesses accounts for customers that classify as higher risk. This could help subsidize the additional costs for account verifications and enhanced screening of transactions for higher risk customers. This would encourage banks to keep “higher risk” customers and transactions within the formal financial sector where suspicious activity can be monitored and reported effectively. This would be of benefit to banks, individuals and the law enforcement agencies that rely on the suspicious transactions to detect and investigate serious crime and terrorist financing. This would mean the state helps to subsidise the cost of monitoring high-risk transactions which is arguably a public function. However this solution is likely to be unpalatable given the current climate of austerity and the large amount of financial aid that the banks received during the financial crisis.

There is then perhaps a role the state owned banks could play in the social inclusion agenda. If other banks are deciding that it is not commercially viable to serve “higher risk” customers then the state owned bank could be required to serve those customers that have struggled to maintain their account at other commercial banks. This would transfer the risks and compliance costs associated with AML and CTF to publically owned banks.

If through government monitoring it was established that de-risking posed a significant threat to financial inclusion that could not be tackled through the private and public sector collaboration the government could legislate directly against disproportionate de-risking. The government could establish legal requirements to open and maintain the accounts of customers that meet the standards of due diligence. We have seen similar laws introduced in Canada however these only establish legal requirement for open accounts, effective de-risking legislation would also establish the conditions for the closure of accounts.

The government has taken a different approach to de-risking and has announced a commitment to reduce the cost of compliance with AML legislation in a bid to reduce the cost of regulation to business by £10 billion. It is not yet clear how this will be achieved as the regulatory standards are largely set at the international and European level. This may not be effective in reducing de-risking as we have seen that through the courts banks have been held to a high standard of liability for their AML/CTF systems and controls. Moreover as international banks continue to operate internationally they will still be required to uphold international standards. As long as they are subject to America regulatory standards and fines will not have an incentive to reduce the quality of their systems and control that they have already invested significantly in. As a result this initiative is unlikely to reduce de-risking and potential will increase AML/CTF risk in the financial sector.

**Conclusion**

De-risking has grown since 2009 into a phenomenon that has commanded international regulatory attention. Driven by the increased costs of compliance with AML/CTF legislation, large regulatory penalties and uncertainty surrounding the limits of banking liability, banks have chosen to exit higher-risk banking relationships and reduce their exposure to AML/CTF risk. As they have done so at least several thousand customers have had their accounts closed and have had to look for alternative banking arrangements. In some markets such as MSB and international trade finance this has reduced competition and limited participant’s ability to operate. Some businesses have not been able to find any banks that will continue to serve them and have had to turn to alternative payments market to continue to operate. This has displaced terrorist financing and money laundering risk from the traditional banking sector into less heavily regulated financial sectors who are less well equipped to detect, monitor and report suspicious transactions.  For individuals de-risking has not had an impact on general levels of financial inclusion however anecdotal evidence suggests that it has had a disproportionate effect on groups from ethnic minority background who were already more likely to be financially excluded. This raised significant question about whether de-risking has involved discrimination against individuals with links to “high-risk” jurisdictions. We have found that cases have varied in their approach to establishing the necessary levels of evidence for discrimination in banking. Some have placed the burden of proof on the plaintiff others have required the defendant to demonstrate that the rationale behind account closures. The secrecy surrounding suspicious activity reporting has made both levels of evidence more difficult to collect. Despite voluntary commitments from UK banks to support financial inclusion initiatives such as fee-free basic banking they have continued to de-risk in a disproportionate manner to reduce their costs and exposure to regulatory sanctions. The current legal framework allows them to do so as banking relationships are understood to be private contractual arrangement governed mainly by the terms of conditions established under contract law. Moreover due to vigilant reporting requirements, banks require very low levels of proof to have legitimate suspicions about the current account activities. This mean it is easier to take action against those who seek to misuse the financial sector but has also meant that it is easier for banks to close accounts of any “higher risk” customer regardless of whether they actually pose a risk to the financial sector. No current regulation requires banks to provide universal banking services and their commitment to basic bank accounts has been purely voluntary made binding only through reputational risk. As a result regulation and lawsuits have driven and enabled de-risking to take place without significant challenge. Despite the prevalence of media reports from across the US, UK and Canada describing situations in which banks have disproportionately de-risked, there are no studies that quantify the extent of de-risking in the UK. Work is under way at the international level to assess the global effects of de-risking but more could be done at the domestic level to understand the prevalence of de-risking. This will take careful collaboration between the public and private sector, this collaboration that has already started strongly but could be supported by legislative changes if voluntary agreements are not sufficient incentives to de-risk proportionally.

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