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EUROSISTEMA

On the application of de-risking policy and the potential impact on financial exclusion

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On the application of de-risking policy and the potential impact on financial exclusion

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SUMMARY

The analysis presents the results of a desk review carried out by the Bank of Lithuania, the aim of which was to assess whether the application of stricter anti-money laundering and counter-terrorism financing (AML/CTF) measures and de-risking policy by the payment service providers supervised by the Bank of Lithuania reduce the accessibility of payment services for various legitimate groups of users.

1. PURPOSE AND METHODS OF ANALYSIS

The Bank of Lithuania carried out an analysis of the practice of applying de-risking policy (hereinafter – “DR policy”) in the second and third quarters of 2021. The aim of the analysis was to determine whether the payment service providers (PSPs) supervised by the Bank of Lithuania applied DR policy and, if they did, whether this did not reduce the accessibility of payment services to the various legitimate groups of payment service users.

Key methods and sources of information for conducting the desk review:

- Complaints and enquiries received by the Bank of Lithuania between 1 January 2020 and 30 June 2021 regarding the money laundering and terrorism financing (ML/TF) risk management measures applied by PSPs (hereinafter – AML/CTF complaints);
- a survey of Payment Service Users (PSUs) and analysis of its results;
- a survey of Payment Service Providers (PSPs) and analysis of its results.

2. DE-RISKING POLICY

Figure 1. Concept, reasons and effect of de-risking policy



3. ANALYSIS OF THE AML/CTF COMPLAINTS RECEIVED BY THE BANK OF LITHUANIA

3.1. General statistics and analysis of AML/CTF complaints

Between 1 January 2020 and 30 June 2021, the Bank of Lithuania received 1,116 complaints and enquiries regarding payment services¹, including 322 complaints regarding AML/CTF measures² (see Figure 2), which account for 28.85% of all complaints received regarding payment services during the analysis period.

Figure 2. Distribution of AML/CTF complaints by year

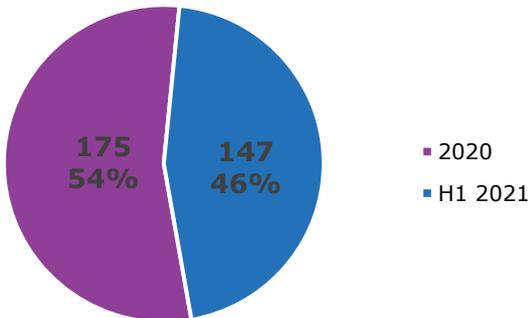
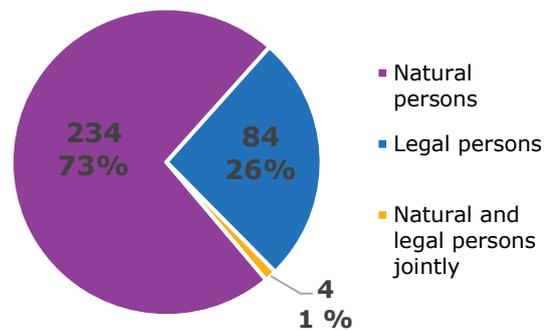
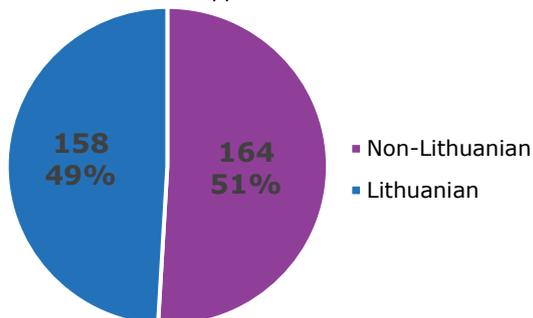


Figure 3. Distribution of AML/CTF complaints by type of applicant



Note: The nationality (place of establishment) of a person is presumed on the basis of the data provided in the AML/CTF complaints but does not necessarily coincide with the person's actual place of residence (place of activity) (see Figure 4).

Figure 4. Distribution of AML/CTF complaints by the nationality (place of establishment) of applicant



In the first half of 2021, the number of applicants who filed complaints regarding AML/CTF measures and who might be non-citizens of the Republic of Lithuania or entities registered outside the Republic of Lithuania, increased by 37.68% as compared to 2020 (see Figure 2).

The number of complaints about the ML/TF risk management measures taken by electronic money institutions (EMIs) is increasing significantly. In the first half of 2021 alone, the number of complaints regarding EMIs was 30.34% higher than throughout the whole of 2020 (see Figure 5).

Figure 5. Distribution of AML/CTF complaints by type of service provider

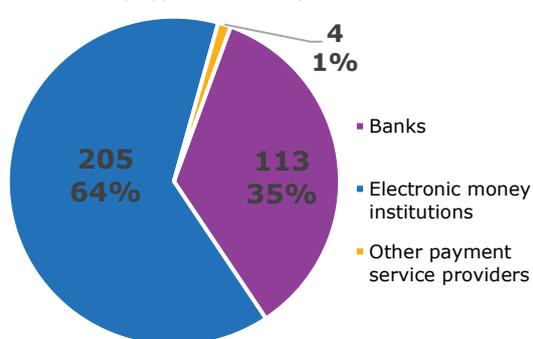
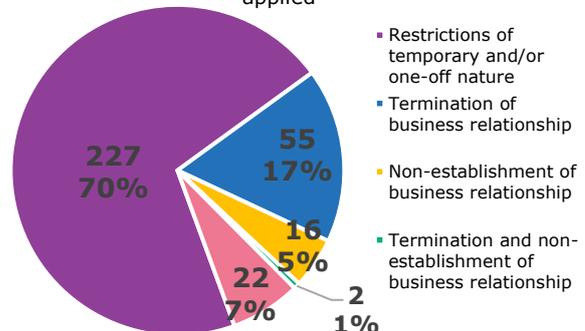


Figure 6. Distribution of AML/CTF complaints by type of ML/TF risk management measures applied



¹ The number of complaints stated does not include duplicate complaints on the same subject from the same applicant, whistleblowing reports and/or complaints relating to whistleblowing issues.

² The number of complaints stated does not include complaints which, although they may have contained circumstances similar to the possible application of ML/TF risk management measures, did not contain sufficient information to suggest that the applicants had applied specifically about ML/TF risk management measures (e.g. complaints about the restriction of a payment account may have been made as a result of the attachment of funds in a payment account by bailiffs, etc.).

The number of complaints about banks' application of ML/TF risk management measures in the first half of 2021 remained similar compared to the same period in 2020.

70% of the total number of AML/CTF complaints received during the period under analysis (227 out of the total of 322 AML/CTF complaints) were complaints about information and/or documents requested by PSPs in the course of a business relationship (BR), restrictions of a short-term and/or one-off nature (e.g. restrictions of payment accounts and/or payment instruments and/or interception of payment transactions, requesting to indicate the origin of funds, to provide documents substantiating the legality of payment transactions or other information) (hereinafter – temporary and/or one-off restrictions), which, according to the Bank of Lithuania's data, did not result in termination of the BR and/or refusal to enter into a BR. According to the complaint data about temporary and/or one-off restrictions imposed on applicants, the reasons for such restrictions were mostly related to the PSPs' BR monitoring procedures and/or inspections initiated due to uncharacteristic actions observed by the PSPs, suspicions raised by the PSPs about payment transactions on applicants' payment accounts, etc. No evidence has been found to suggest that the imposition of restrictions of this nature may have been linked to the possible application of DR policies by the PSPs being reported in the complaints.

The analysis of the AML/CTF complaints shows that, in many cases, clearer communication between the PSPs on the information being requested and/or the scope, objectives and/or duration of other measures being taken to manage the ML/TF risks, as well as closer cooperation between the PSPs and the applicants in the exchange of relevant information, could have helped avoid the situations and/or disagreements between the PSPs and the applicants referred to in the AML/CTF complaints.

3.2. Statistics and analysis of complaints about termination and non-establishment of a BR,

During the period under review, complaints about the termination of a BR³ accounted for 17.7% and complaints about a refusal to establish a BR⁴ accounted for 5.6% of the total number of AML/CTF complaints.

Before terminating a BR with the applicants, the PSPs had attempted to manage the identified risks by means of softer ML/TF risk management measures (e.g. payment account restrictions, payment hold, refusal to execute specific payment transactions, etc.) in 29 complaints (50.9% of the total number of BR termination complaints).

Figure 7. Distribution of complaints about BR termination or non-establishment by type of applicants (2020)

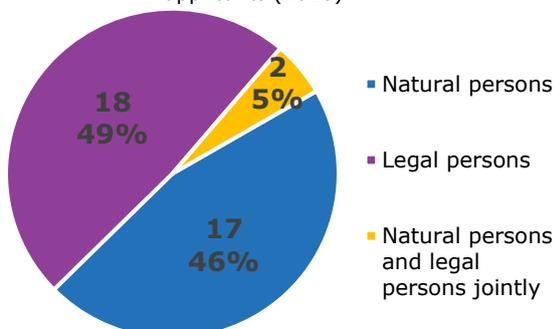


Figure 8. Distribution of complaints about BR termination or non-establishment by type of applicants (H1 2021)

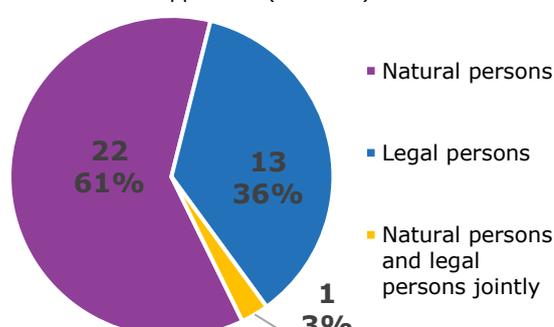


Figure 9. Distribution of complaints about BR termination or non-establishment by type of payment service providers (2020)

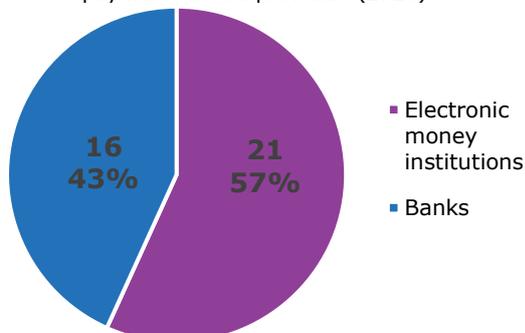
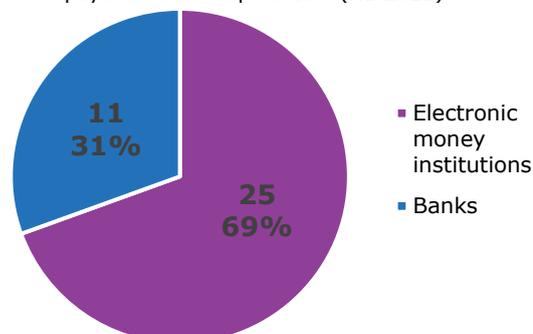


Figure 10. Distribution of complaints about BR termination or non-establishment by type of payment service providers (H1 2021)



³ Including two AML/CTF complaints which simultaneously complained about both the termination of a BR and a refusal to enter into a new BR.

⁴ Including two AML/CTF complaints which simultaneously complained about both the termination of a BR and a refusal to enter into a new BR.

The most frequent reasons for complaints about termination and non-establishment of a BR (a total of 73 AML/CTF complaints) were related to suspicions raised by the PSPs about the possible illegal, undeclared or fictitious activities of the applicants (31.51% of all complaints on termination or non-establishment of a BR) and to failure to provide the documents and/or information requested by the PSP (20.03% of all complaints on termination or non-establishment of a BR). Unknown reasons for termination and non-establishment of a BR account for 32.88% of all complaints about BR termination or non-establishment. They remain unknown because the complaints by the applicants contained material deficiencies (e.g. anonymous and/or unsigned appeals were submitted, the names of the PSPs being reported were not indicated, the circumstances of the situation were not specified, the PSPs had not been contacted prior to submitting a complaint, etc.), which were not resolved by the applicants, and, as a result, further examination of such complaints by the Bank of Lithuania was not possible.

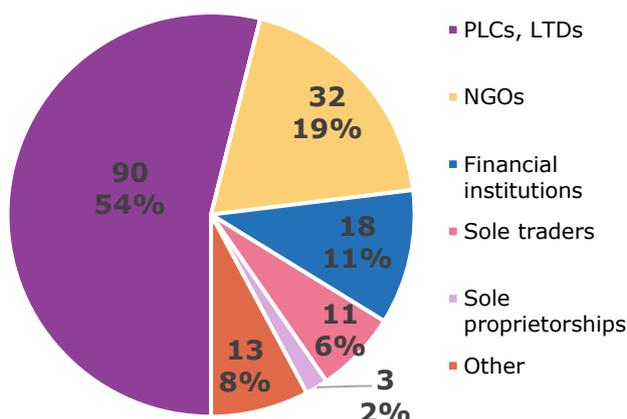
There were no clear instances of the application of DR policies among the examined complaints on termination or non-establishment of a BR.

ANALYSIS OF PSU SURVEY RESULTS

4.1. General information about the survey and the respondents

A total of 167 respondents took part in the survey. The survey was anonymous.

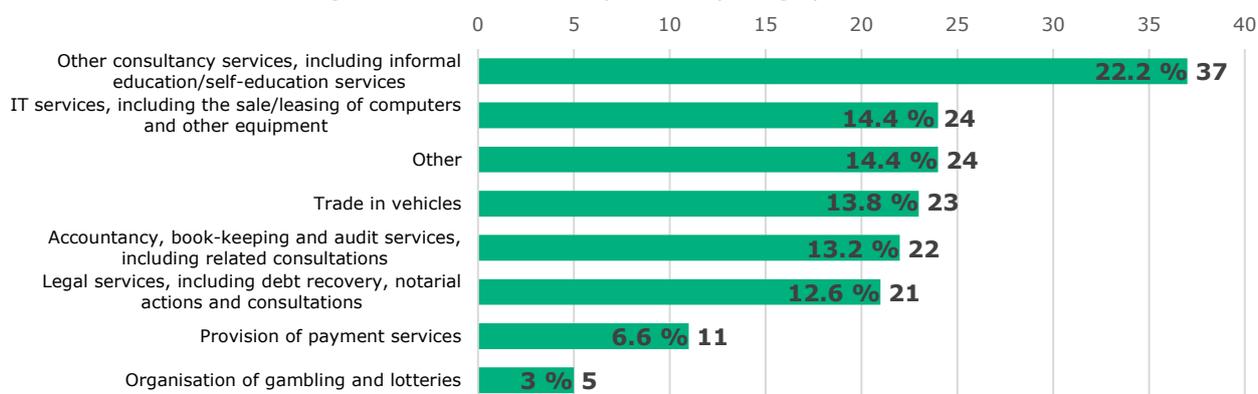
Figure 11. Distribution of respondents by type



Target sectors of respondents' activities⁵:

- 1) non-profit and/or other non-governmental organisations, including religious or other communities (hereinafter – NGOs);
- 2) financial institutions (EMIs, banks and specialised banks, credit unions, holding companies);
- 3) companies organising gambling and lotteries;
- 4) legal service providers (e.g. lawyers, notaries);
- 5) firms providing accounting and/or tax advisory services;
- 6) public limited companies (PLC), private limited companies (LTD), sole proprietorships and/or sole traders whose main activities are related to the sale of vehicles, consultancy and/or the provision of information technology (IT) services.

Figure 12. Distribution of respondents by category of activities



⁵ The sectors were chosen on the assumption that entities belonging to these sectors would be most likely to be exposed to the application of DR policy.

During the survey, respondents were asked to indicate whether they had been subject to any of these measures in the last two calendar years:

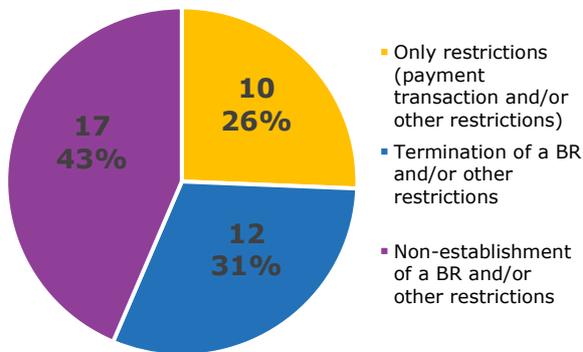
- 1) refusal to establish a BR;
- 2) termination of a BR;
- 3) restrictions on payment transactions;
- 4) application of other restrictions during the BR, such as refusal to issue a payment card, provide a payment processing service, etc.

It should be noted that 128 (76.6%) of the respondents indicated that none of the ML/TF risk management measures mentioned above had been applied to them during the period under review.

4.2. Analysis of data provided by survey respondents who were subjected to ML/TF risk management measures

Only 39 respondents (23.4% of all respondents) were subjected to the application of ML/TF risk management measures. Some of them indicated that they had been subjected to several different ML/TF risk management measures and/or these measures had been applied more than once.

Figure 13. ML/TF risk management measures applied to 39 respondents



It is not known exactly which restrictive measures were applied to 10 respondents. It is possible that the restrictions may have been of a one-off and/or short-term nature (e.g. interception of a payment transaction where the PSP asks for additional information about it, etc.).

The 29 respondents who experienced termination and/or non-establishment of a BR represent 17% of the total number of respondents, but there is insufficient evidence from the survey to suggest that the cases reported by these respondents may have been indicative of the application of DR policy.

Figure 14. Distribution of respondents who faced termination or non-establishment of a BR by category of activities



The most common reasons given by PSPs for their decisions to terminate and/or not to establish a BR were as follows:

- 1) the need to manage ML/TF risks, without citing specific reasons (48%);
- 2) unacceptable activity of the survey respondent (31%);
- 3) failure to provide information/documents requested by the PSP (24%).

The details of the circumstances and/or reasons for the termination and/or non-establishment of BRs are not known, and it is therefore not possible to assess what led to such decisions by the PSPs and/or what activities and/or actions of a particular respondent could have been deemed unacceptable by the PSPs (the type of activity itself and/or specific characteristics of the activities of the specific respondent and/or other circumstances relating to the specific respondent).

It should be noted that these respondents do not stand out from other respondents who have not been faced with the termination and/or non-establishment of a BR, and the information provided by them does not provide any grounds to suggest that the nature of their activities, the structure of their shareholders and/or beneficiaries, etc., might have had a significant impact on the PSP's decision to terminate and/or not establish a BR with them.

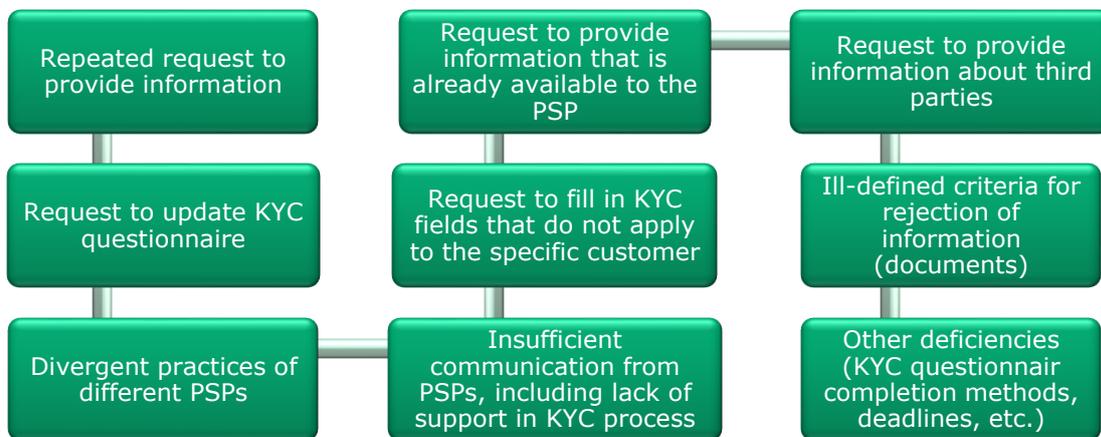
4.3. Other observations by survey respondents on the PSPs' ML/TF risk management policies

During the survey, the participants were given the opportunity to express their additional observations and/or complaints regarding ML/TF risk management measures applied by PSPs and/or the PSPs' communication about the application of these measures (in a free-form manner), irrespective of whether the participant had been subject to ML/TF risk management measures.

48 respondents (29% of all respondents) gave their comments/complaints.

The most frequent observation/complaint was in relation to the updating and/or submission of the Know Your Customer (KYC) questionnaires and/or provision of other information requested by the PSP (79%). The most common reasons for complaints are shown in Figure 15.

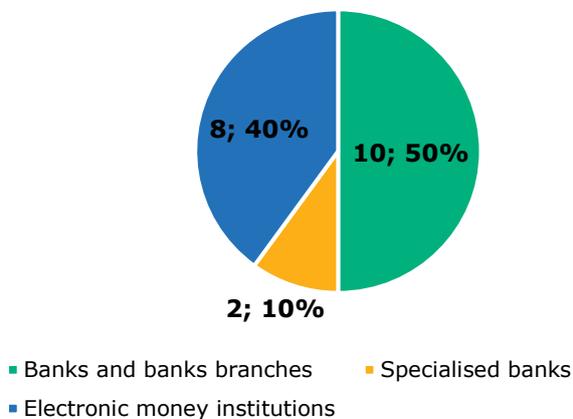
Figure 15. Common reasons for complaints



ANALYSIS OF PSP SURVEY RESULTS

5.1. General information on the survey and the participating PSPs

Figure 16. Distribution of PSPs by type



The Bank of Lithuania carried out a survey of PSPs; 20 PSPs were sent the questionnaire, and 19 of them submitted their answers⁶.

The survey aimed, inter alia, to determine whether PSPs have defined in advance in their internal procedures in which cases and/or for which categories/groups of customers they do not establish BRs, and to identify the most frequent reasons for not establishing a BR, terminating it or establishing it with certain restrictions.

5.2. Analysis of reasons given by PSPs for termination and non-establishment of a BR and/or its establishment with certain restrictions

Based on the data provided by PSPs, the most common reasons for PSPs' decisions not to establish or terminate a BR and/or to establish a BR with certain restrictions can be identified as follows (see Table 1).

Table 1. Reasons for termination or non-establishment of a BR and/or its establishment with certain restrictions

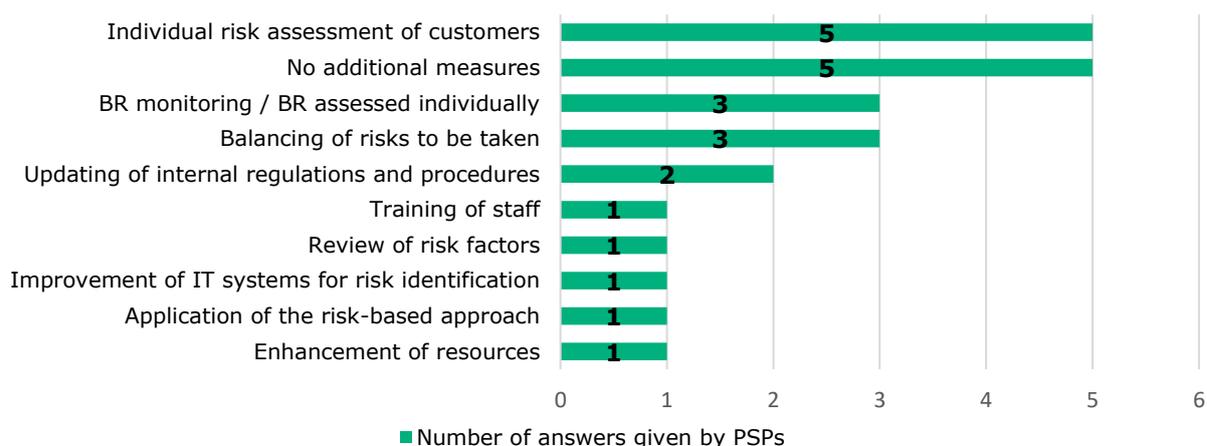
No	Reason	Number of PSP responses
1.	Unacceptable, suspicious and/or risky customer activity, possible cases of customer fraud	13 (72%)
2.	Failure to update customer information during the period of the BR, non-cooperation and/or refusal by the customer to provide information to the PSP, failure or refusal by the customer to provide detailed information prior to the establishment of a BR	12 (67%)
3.	Risks of non-compliance with legal requirements (e.g. where final beneficiaries cannot be identified, risks of sanctions, risks of misidentification)	11 (61%)
4.	Indications of fictitious and/or unclear activities of the customer, unreasonableness of the customer's activities and/or unreasonableness of the customer's activities with the Republic of Lithuania	10 (56%)
5.	Negative information that is available and/or has emerged in the public domain, both about the customer and the customer's beneficiaries	9 (50%)
6.	Unclear origin of the customer's funds and assets, unclear payment transactions of the customer, unclear purpose and nature of the BR	7 (39%)

5.3. Measures to mitigate/manage the negative effects of DR policies

During the analysis, the PSPs were asked to indicate what measures they have taken or intend to take to mitigate/manage the negative consequences arising from the DR policy process. Of the 17 respondents, five PSPs said they considered that no additional measures were needed and that the current measures were proportionate. In addition, the PSPs identified individual ML/TF risk assessment of customers (5), the balancing of the risks to be taken (3), the monitoring of BRs or individual assessment of BRs (3) as possible measures.

⁶ The survey covered entities belonging to the types of payment service providers with the highest number of complaints (e.g. credit unions and payment institutions were excluded from the survey due to the extremely low number of complaints received against them).

Figure 16. Mitigation (management) measures for negative consequences of DR policies



5.4. Internal procedures of PSPs used not to enter into BRs with certain categories of customers

The PSP survey sought to establish whether PSPs have defined in their internal procedures and/or other internal regulations the categories of natural persons, legal persons and financial institutions with whom they have decided not to enter into BRs.

18 out of the 19 PSPs responded that they had internal procedures in their internal processes to exclude certain categories of customers.

Based on the information obtained in the survey, the PSPs' responses regarding cases of non-establishment of BRs with customers have been grouped as follows (see Table 2).

Table 2. Cases of non-establishment of BRs

No	Non-establishment of a BR	Number of PSP responses
1.	The person's activities are related to illegal and/or criminal activities	12 (63%)
2.	Companies and banks with fictitious signs	9 (47%)
3.	Persons cannot be identified and/or it is not possible to meet AML/CTF requirements related to establishment of beneficiaries	10 (53%)
4.	Persons engaged in activities related to crypto-asset	8 (42%)
5.	Persons and/or partners are subject to international financial sanctions	7 (36%)
6.	Persons associated with high-risk jurisdictions (according to the Financial Action Task Force (FATF) and European Commission (EC) lists)	13 (68%)
7.	Activities of the persons related to dual-use goods	1 (5%)
8.	Entities whose management is carried out through bearer shares or nominee shareholders	8 (42%)
9.	Opening of an account for the purpose of safeguarding the funds of an EMI and PI and/or for the purpose of executing customer transactions	1 (5%)
10.	The customer and/or beneficiary is a politically exposed person	3 (16%)
11.	The potential customer is a non-profit organisation	1 (5%)
12.	Risky customer activities in accordance with the institution's established internal procedures	1 (5%)

It should be noted that the assessment of the responses provided by the PSPs regarding the non-establishment of BRs with certain categories of customers does not show a trend regarding the application of DR policy towards a specific category of customers. According to the information provided by the PSC, the most common criteria for inclusion in the lists for non-establishment of a BR are illegal activities, signs of fictitious companies, nominee shareholders, etc.

It should be noted that, although the lists of customer categories with which PSPs have decided not to enter into a BR are mostly based on the objectives of the management of ML/TF risks, PSPs need to ensure that legitimate businesses (regardless of the higher ML/TF risk activities and/or higher ML/TF risk jurisdictions) have access to the basic payment services and that they are not unduly denied access to financial services. As highlighted in the European Banking Authority's (EBA) revised Guidelines on ML/TF Risk Factors, published in

March 2021⁷, while the risks associated with an individual BR may differ even within the same category of customers, based on the application of the risk-based approach, PSPs should not exit and/or terminate BRs with an entire category of customers that are considered to be at a high ML/TF risk.

6. IMPACT OF CORRESPONDENT BANK POLICIES OF BANKS ESTABLISHED IN OTHER COUNTRIES

Both FATF and EBA point to the increase in risks associated with correspondent banking relationships as one of the factors that may lead to the application of DR policies. The requirements for ML/TF prevention apply to correspondent banking relationships, calling for management of the risks associated with these business relationships and for the application of appropriate customer due diligence measures. Recently, there has been observed an increasing number of cases where correspondent banks chose to avoid rather than manage the potential ML/TF risks and have terminated or restricted their BRs with customers in a particular region or with certain categories of customers. In such cases, the respondent banks either lose correspondent service providers or, in order to preserve the correspondent relationship, often decide to terminate their BRs with customers categorised as having a high ML/TF risk.

The trend of decreasing accessibility of correspondent banking services can also be observed in Lithuania. The Bank of Lithuania has been receiving information on cases of refusal to establish correspondent relations or termination of correspondent relations, as well as closure of PSP and PSU accounts due to changes in the correspondent banks' policies. The results of the PSP survey also suggest that PSPs, in establishing or maintaining a BR, assess the information or policies of correspondent banks with regard to certain PSUs or categories of PSUs. In assessing the impact on the establishment of correspondent relationships with potential partners, PSPs may tend to have fewer clients in the high ML/TF risk category.

The Bank of Lithuania will continue to monitor and analyse to what extent and in what way the changes in correspondent banks' policies have an impact on PSPs' business relationships with PSUs.

7. ANALYSIS OF INTERNATIONAL APPLICATION OF DR POLICIES

It should be noted that DR policy issues are currently being raised by both international (FATF) and EU organisations (EBA):

- In the first half of 2021, the EBA shared the actions it has taken to address DR policy⁸.
- It should be noted that the EBA is planning to publish an opinion covering possible ways to manage DR policy and mitigate the resulting effects. This opinion will be addressed primarily to the national supervisory authorities and the EU legislator and will deal with changes to the legislative framework.
- It should also be noted that the FATF launched a project in February 2021 to investigate and mitigate the unintended consequences arising from the inadequate implementation of the FATF standards.⁹ On 27 October 2021, FATF published a paper¹⁰, which provides an overview of the nature of possible DR policy and the factors driving them. It is noteworthy that FATF is also planning to issue guidelines and best practices and organise training on how to mitigate the possible manifestations of DR policies.

8. CONCLUSIONS AND SUGGESTIONS

In the light of the results of the desk review, the following conclusions can be drawn on the application of DR policy:

1. The results of the analysis of the AML/CTF complaints (322 complaints in total) do not lead to the conclusion that, in the cases of non-establishment and/or termination of BRs identified, the PSPs refused to establish and/or terminated the BR due to DR policy.
2. The results of the analysis of the PSU survey do not lead to the conclusion that in the 29 cases of non-establishment and/or termination of BRs identified by the PSUs, the PSPs refused to establish and/or terminated a BR because of DR policies.

⁷ https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Guidelines/2021/Guidelines%20on%20ML-TF%20risk%20factors%20%28revised%29%202021-02/Translations/1016933/Guidelines%20ML%20TF%20Risk%20Factors_LT.pdf

⁸ <https://www.eba.europa.eu/eba-takes-steps-address-%E2%80%98de-risking%E2%80%99-practices>

⁹ <https://www.fatf-gafi.org/publications/financialinclusionandnpoissues/documents/unintended-consequences-project.htm>

¹⁰ <https://www.fatf-gafi.org/media/fatf/documents/Unintended-Consequences.pdf>

3. The results of the analysis of the PSP survey do not show that non-establishment and/or termination of BRs for specific categories of PSUs has been applied as a DR policy measure during the reporting period.
4. The desk review has identified that customers in the business of crypto-assets may face greater difficulties in establishing a BR, but it has not been currently established that such customers would have no access to payment services at all (less than 50% of PSPs do not establish BRs with such customers).

Taking into account the conclusions of the desk review on the application of DR policy, the next steps to be taken by the Bank of Lithuania are as follows:

1. Continue to monitor the application of DR policy and put in place tools and processes to ensure such monitoring.
2. Monitor and actively engage in the EBA's process of drafting documents on balancing the legislation on payment services and AML/CTF measures.

It should be noted that the desk review also identified other shortcomings which, although not related to the application of DR policy, are encountered by PSUs when using PSP services:

1. PSUs are confronted with a lack of clarity, vagueness and insufficient communication from PSPs regarding the information being requested by PSPs for AML/CTF purposes.
2. In the course of BR monitoring actions, PSPs in certain cases hold (suspend) their customers' payment transactions and/or restrict their customers' access to payment accounts, at the same time requesting additional information to substantiate the origin and sources of the customer's funds, the payment transaction being made (or already made) or other circumstances. In many cases, customers are not informed in advance of the likely duration and/or progress of the process of assessing the documents and information requested by the PSP, including lack of information of how long the restrictions imposed by the PSP may last and/or what else the client could do in order to have them lifted as soon as possible (where feasible). It has been noted that the process of assessing the documents submitted by the customer and, in some cases, the actual contacting of the customer for the submission of such documents takes a considerable amount of time for some PSPs, which consequently means that the restrictions imposed on the customer last for the same amount of time.

In view of the other shortcomings identified during the analysis, the following actions are proposed:

1. Draw the attention of the PSPs to the need to improve and enhance communication with customers when requesting information from a customer for the purpose of ML/TF risk management, including but not limited to clearly communicating to customers about the information to be provided, giving a reasonable timeframe for the provision of the information, indicating the possible alternatives to the requested information in cases where the customer indicates that it is not possible to provide the information requested, etc.
2. Identify and implement measures to improve customer experience with regard to AML/CTF measures and other procedures taken by PSPs.
3. Evaluate the need and feasibility of establishing and/or otherwise defining clearer requirements for the restriction of payment accounts and/or suspension of payment transactions on the basis of ML/TF risk management, insofar as this does not conflict with the requirements of the AML/CTF law.

It should be noted that regarding the above areas, the Bank of Lithuania will launch public consultations in order to obtain views, suggestions and/or other observations of stakeholders in order to improve PSU experience when using PSP services and with regard to AML/CTF measures and other procedures taken by PSPs.