The Africa continent, and the West Africa region in particular is ripe for technological advancement. The region is currently witnessing what may be referred to as a Fintech boom with Governments, Central Banks and financial institutions implementing policies to support the same. Since the launch of M-Pesa in 2007 by Safaricom in Kenya, mobile money use has risen exponentially in Africa. According to the Findex Survey conducted in 2017, it is estimated that 21% of all adults in Sub-Saharan Africa had access to mobile wallets in 2017, as opposed to 12% in 2014 (World Bank, 2017). Although the use of mobile money services presents some form of competition to crypto assets, one positive impact it has had on the latter is that it has led to Africans trusting new forms of financial innovation according to Chainalysis (2020). The changing digital banking landscape in the region is expected to transform West Africa as a Fintech hub and thus financial institutions are on a drive to update and upgrade their systems in order to meet the fast pace of digital transformation and be competitive. In the next few years financial institutions with better systems in driving financial products are expected to have far greater footprints than the brick and mortar institutions as virtual banking and technology driven financial services products becomes more appealing to the mass market.

**BACKGROUND**

The Africa continent, and the West Africa region in particular is ripe for technological advancement. The region is currently witnessing what may be referred to as a Fintech boom with Governments, Central Banks and financial institutions implementing policies to support the same. Since the launch of M-Pesa in 2007 by Safaricom in Kenya, mobile money use has risen exponentially in Africa. According to the Findex Survey conducted in 2017, it is estimated that 21% of all adults in Sub-Saharan Africa had access to mobile wallets in 2017, as opposed to 12% in 2014 (World Bank, 2017). Although the use of mobile money services presents some form of competition to crypto assets, one positive impact it has had on the latter is that it has led to Africans trusting new forms of financial innovation according to Chainalysis (2020). The changing digital banking landscape in the region is expected to transform West Africa as a Fintech hub and thus financial institutions are on a drive to update and upgrade their systems in order to meet the fast pace of digital transformation and be competitive. In the next few years financial institutions with better systems in driving financial products are expected to have far greater footprints than the brick and mortar institutions as virtual banking and technology driven financial services products becomes more appealing to the mass market.

**WHY THIS POLICY BRIEF?**

The changing digital banking landscape in West Africa is expected to transform the region as a Fintech hub and thus financial institutions are on a drive to update and upgrade their systems in order to meet the pace of the digital transformation and be competitive.

We must ensure that the transformation takes full account of AML/CFT requirements.
Notwithstanding these enormous opportunities, digital finance raises new ML/TF risks and challenges.

New areas of vulnerability might develop because of new financial products (cryptocurrencies and other forms of new technologies).

Digital finance gives rise to an increasing number of financial players and eases cross-border transactions, which makes the monitoring of transactions more complex for financial institutions and competent authorities. Furthermore, while new financial players are reshaping the financial sector, they may be outside the scope of the banking sector regulation and subject to less stringent AML/CFT rules in comparison to banks. If not proportionate to the ML/TF risks, these regulatory gaps or loopholes may lead to some distortion of competition, which may violate the level playing field principle and lead to increased potential for financial crime.

However, in recent times there has been some significant technological transformation that is changing the banking landscape particularly in extending financial services to the “unbanked”. This is where Fintech come in; these new entrants to the banking space are adopting technology in promoting the financial inclusion agenda as well as deepening the use of financial services. Fintech are agile, innovative, have less bureaucracy and have uniquely harnessed the power of West Africa’s high rate of mobile penetration to transform the financial services landscape.

Today Fintech is enabling billions of transactions globally in areas such as:
- Domestic money transfer;
- International money transfers;
- Funds deposits;
- Retail payments;
- Payment for utility services and taxes;
- Disbursement of funds;
- Delivery of social welfare.

With the growing adoption of Fintech products, Fintech has changed the way traditional financial institutions have in the past offered financial services; their business models adopted are small and usually starts as a hub and their operations are built to be mobile. With an 83% mobile penetration across West Africa, there is opportunity for Fintech to transform how financial services are offered. ‘The Learn as we go model’ in emerging markets in Ghana, Nigeria, Cote D’Ivoire, Senegal, Togo, Benin, and Cameroun have all exceeded expectations.
FACTORS RESPONSIBLE FOR FINTECH TRANSFORMATION IN WEST AFRICA

The following factors have contributed immensely to the growth and transformation of Fintech in West Africa:

1. An increase in the usage of mobile devices;
2. An increase in the use of 3rd party integrations that enable Fintech to leverage on customers of financial institutions to offer solutions;
3. The gaps in the provision of local financial services to a growing population across the sub-region (to address financial exclusion challenges);
4. An increase in Regulation and policy framework to guide the evolution of Fintech;
5. Adoption of Regulatory sandboxes by African Central Banks to harness innovation;
6. The adoption of the Bali Fintech Agenda is an important milestone as it brings this emerging trend to the centre stage.

ML/TF RISK IN RELATION FINTECH AND APPLICATION OF RISK BASED APPROACH

Perhaps one of the main reasons for the rapid growth and adoption of Fintech is its potential to improve financial inclusion. According to the Alliance for Financial Inclusion (AFI), Fintech has the potential to benefit underserved individuals and communities by promoting financial inclusion. In its 2020 report on Fintech and financial inclusion in the post covid-19 era, the International Monetary Fund (IMF) shares the same point of view, citing testimonies of low-income households and SMEs who confirm benefitting from lower service cost, little or no collateral requirements for credit extension, and typically better customer experience from Fintech-related services.

However, like all forms of financial services, there is a tendency for Fintech to be misused for money laundering and terrorism financing purposes. A 2020 Interpol report on mobile money and organized crime in Africa highlights that “the development of mobile money services in Africa offer criminals a substantial opportunity to utilize these services to target victims in a variety of crimes as well as to further enable other forms of criminality including money laundering”.

OBSERVED TRENDS

Fintech is enabling billions of transactions globally in areas such as:
* Domestic money transfer
* International money transfers
* Funds deposits
* Retail payments
* Payment for utility services and taxes
* Disbursement of funds
* Delivery of social welfare
The FATF, in its 2013 Guidance for a Risk-Based Approach to Prepaid Cards, Mobile Payments and Internet-Based Payment Services also identified risk factors associated with these new payment methods. These include their non–face-to-face nature; customer anonymity; wide geographical reach; methods of funding; global access to cash and segmentation of services.

These revelations point to the need for AML/CFT regulation of Fintech to address its inherent ML/TF risks. However, the dilemma is that conventional AML/CFT preventive measures such as Know Your Customer/Customer Due Diligence (KYC/CDD), tend to act as roadblocks for financial-inclusion driven Fintech if not properly apportioned. While the World Bank (2008) report acknowledges that “measures (such as Fintech services) that ensure more clients use formal financial services increase the reach and effectiveness of the AML/CFT controls”, the Consultative Group to Assist the Poor (CGAP), on the other hand pointed out that “AML/CFT measures can negatively affect access to, and use of, financial services if those measures are not carefully designed” (CGAP, 2009).

As such, some regulators are trying to adopt a risk-based approach to AML/CFT regulation of Fintech, as per FATF Recommendation 1. AFI member countries, for example, in their efforts to regulate innovative deployments in their local markets, are implementing proportionate regulatory approaches and adopting a “test and learn” methodology. One such measure is the adoption of a tiered KYC/CDD approach for financial services. This approach should however involve a wide range of consultations with respective stakeholders who will weigh in the stakes in relation to risk and financial inclusion. As a risk mitigating measure, some countries in the region have agreed on transaction thresholds for different customer categories taking into account the amounts, frequency of transactions and conducting the minimum KYC/CDD requirements as applicable.

Considering the sizeable segment of the West-African region that is excluded from the formal financial service sector, coupled with the general low earnings of the residents of the region, it can be reasonably deduced that the adoption of a tiered KYC/CDD approach presents the opportunity to improve financial inclusion and, by extension, financial regulatory oversight within the region. However, such measures must be accompanied by adequate controls to ensure that criminals do not abuse financial inclusion-driven schemes. Some of the challenges associated with the adoption of a tiered-KYC/CDD framework within the mobile money sector include the following:
1 LOW CUSTOMER AWARENESS OF ML/TF ISSUES

The level of public awareness of money laundering and terrorist financing issues is still relatively low in the West African sub-region. As such, by allowing individuals to register mobile money wallets using guarantors’ identification documents opens up possibilities for criminals to use unsuspecting individuals to open third-party accounts with no traceable ties to them.

2. AGENT-RELATED CHALLENGES

The use of third-party agents by mobile money service providers can be two-fold. It may be direct, as in the case of agents who provide mobile money services such as cash-in and cash-out to consumers; or indirect, as in the case of SIM card dealers who may register customer accounts without providing any other mobile money related services. The latter generally operate on commission basis and may neither be aware of their KYC/CDD obligations, nor be subject to any training or compliance oversight by the mobile money operator. This category of agents makes the mobile money system especially vulnerable to abuse by money launderers and terrorist financiers, as they may not take the necessary precautions when registering accounts, which will become part of the financial system.

3. SYSTEM CHALLENGES

Some mobile money service providers acquire their core systems from third-party institutions. As such, the restrictions imposed by tiered-KYC/CDD frameworks may not be available on their systems by default. As a result, these companies may need to initiate ‘change requests’ with their core service providers, which are often complex, time-consuming and expensive. This may hinder the implementation of the requirements of tiered-KYC/CDD frameworks at institutional level.

Furthermore, one of the key components of a tiered-KYC/CDD regime is the ability to program systems to ensure that customers are restricted to their pre-determined transaction thresholds. Where individual mobile money systems are incapable of programming such restrictions, countries may find encounter challenges in rolling out tiered-KYC/CDD programs.

4. TRANSACTION MONITORING CHALLENGES

One of the main objectives of setting transaction tiers in a tiered-KYC/CDD framework is to mitigate the risk of abusing accounts for illicit purposes. However, the relative ease with which individuals can create mobile money accounts creates the tendency for criminals to create multiple accounts to launder their illicit proceeds. Thus, it is crucial that mobile money service providers have mechanisms in place for good transaction monitoring capabilities to flag and report suspicious transactions, as well as competent compliance staff to oversee these systems. Where such measures are absent, it is very likely that criminal activities would go undetected.
The relative ease with which individuals can create mobile money accounts provides criminals with equal opportunity to open multiple accounts to launder their illicit proceeds. Thus, it is crucial that mobile money service providers have mechanisms in place for good transaction monitoring capabilities to flag and report suspicious transactions, as well as competent compliance staff to oversee these systems.

5. REGULATORY CHALLENGES

Regulatory authorities generally take on pioneer roles in the development of tiered-KYC/CDD frameworks. However, the proper execution of such regimes requires robust regulatory oversight to ensure that service providers uphold their obligations in implementing thresholds, monitoring transactions, etc. Without such regulatory oversight, it is highly likely that tiered-KYC/CDD regimes would be misused for ML/TF purposes.

RECOMMENDATIONS FOR THE WEST AFRICAN REGION

The following recommendations are made for Member States and Regional authorities:

MEMBER STATES

1. Adequate legal and regulatory frameworks to be adopted to promote the work of FinTech across the sub-region;
2. Adopt a dynamic governance approach for the FinTech industry in order to respond speedily to innovation with their regulations and supervisory functions;
3. Consider the development of an integrated FinTech deployment and governance strategy, in collaboration with relevant stakeholders, in order to provide guidance for the industry.
4. FinTech regulators in Member States should have guidelines for entry controls in relation to FinTech operators and CDD in relation to customers;
5. The Central Banks, in collaboration with the Ministries of Finance and other stakeholders, should lead and engage the FinTech ecosystem in their countries in order to develop a national governance framework, including AML/CFT regulations and supervision, across the FinTech landscape;
6. Considering the specialized nature of the FinTech sector, member States should consider where possible establishing legislation(s) to provide for Self-governance of the industry in order to ensure effective AML/CFT compliance, with close regulatory monitoring;
7. Member States provide relevant training to their personnel in the area of prevention (including public awareness), regulation and supervision, investigation, prosecution and adjudication of financial crimes linked to the operations of Fin Tech.
REGULATORY AUTHORITIES

1. ECOWAS, the West African Monetary Agency (WAMA), BCEAO, GIABA, in collaboration with other stakeholders, should engage the Fintech ecosystem at the regional level in order to develop and adopt a common regional policy guideline on Fintech and AML/CFT compliance;
2. Collaboration within the two Monetary zones in the region should be enhanced in order to build AML/CFT compliance systems that will promote the adoption and rapid evolution of Fintech.
3. GIABA should continuously monitor and report on the ML/TF risks associated with Fintech in order to enhance AML/CFT compliance.

WHAT SHOULD YOU DO?

* Put in place strong legal and regulatory frameworks to promote the work of Fintech;
* Adopt dynamic governance approaches for the Fintech industry in order to respond speedily to innovation in their regulations and supervisions;
* Put in place measures that will enable the linking of multiple accounts to their beneficial owners;
* Continuously monitor and report on the ML/TF risks associated with Fintech in order to enhance AML/CFT compliance.

Member States are hereby urged to share this Policy Brief with their National Competent Authorities and other relevant stakeholders in order to take relevant action.