

BANKING AGENCY OF REPUBLIKA SRPSKA

GUIDELINES

TO REMEDY NEGATIVE CONSEQUENCES OF EXCESSIVE IMPLEMENTATION OF ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING REQUIREMENTS

Banja Luka, February 2025

Pursuant to Article 5, Paragraph 1, Item b), Article 22, Paragraph 1, Item f) and Article 37 of the Law on the Banking Agency of Republika Srpska ("Official Gazette of Republika Srpska" No. 59/13 and 4/17), Article 6, Paragraph 1, Item b) and Article 22, Paragraph 4, Item m) of the Statute of the Banking Agency of Republika Srpska ("Official Gazette of Republika Srpska" No. 63/17), Articles 93 and 101 of the Law on anti-money laundering and counter-terrorist financing ("Official Gazette of BiH", No. 13/24), and Article 47 of the Decision on money laundering and terrorist financing risk management ("Official Gazette of Republika Srpska", No. 22/24), the Director of the Banking Agency of Republika Srpska issued the

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1. INTRODUCTION

The measures undertaken by banks in the process of implementing regulations governing the anti-money laundering and counter-terrorist financing (AML/CFT) in Republika Srpska should be commensurate, adequate, and proportionate to the risk to which banks are exposed or could be exposed in their business operations with clients – private individuals.

The activities of the Banking Agency of Republika Srpska (hereinafter: the Agency) are aimed at supporting the correct implementation of the regulations governing the AML/CFT segment, including the adoption of guidelines regarding the implementation of measures when performing cash transactions. The main objective of the Agency's activities, in the context of these Guidelines, is that banks, in accordance with the risk-based approach (hereinafter: the RBA approach), including measures aimed at protecting financial service users, provide private individuals with access to banking services when depositing cash, and that the measures undertaken by banks in the process of verifying cash transactions are adequate, proportionate and required to meet the stipulated requirements.

It was determined that the implementation of the RBA approach is not at a satisfactory level, due to inadequate risk mitigation and/or avoidance measures, and that financial exclusion of private individuals is still present in the banking sector of Republika Srpska, which is contrary to the regulatory framework and the essence of this approach. Also, the Agency's findings on these undesirable consequences indicate that the incorrect implementation and arbitrary interpretation of AML/CFT regulations and standards have an impact on the growth and ongoing presence of these phenomena, with private individuals having no or limited access to banking services.

The results, i.e. the conclusions of the analysis of the situation and causes, and guidelines to remedy negative consequences are presented below.

2. RISK MITIGATION OR AVOIDANCE

The phenomenon that certain banks, due to incorrect implementation and arbitrary interpretation of AML/CFT standards, terminate or limit business relationships with certain clients or categories of clients in order to mitigate and/or avoid risks, i.e. refuse to execute transactions and refuse to pay-in cash, instead of managing risk in accordance with the RBA approach has been recognized. Mitigating and/or avoiding risk in this way leads to limited access to banking services for private individuals.

Namely, preventing a client from accessing financial services may result in risk mitigation and/or avoidance, whereby such measures are contrary to the proper implementation of the RBA approach promoted by the regulatory framework in Republika Srpska, i.e. in BiH, which is key to the effective

implementation of AML/CFT international standards. Also, such measures do not contribute to reducing the number of unregulated financial transactions that take place outside the regulated financial system.

Mitigating and/or avoiding risk by disabling access to financial services may result in private individuals facing delayed transactions and transactions with higher costs, and some financial transactions are likely to take place outside the regulated financial system, which poses additional risk.

The causes of inadequate risk mitigation and/or avoidance measures are the result of a number of factors, which vary in importance depending on the specific case, among which the following stand out:

- profitability issue that in some situations leads to the implementation of insufficient measures and increased risk exposure, while in other situations influences the excessive implementation of additional measures, including measures not related to the AML/CFT;
- incorrect implementation of the AML/CFT regulations and standards, as well as the failure to apply the RBA approach, and
- reduced risk appetite due to reputational concerns.

Banks' activities and complaints that clients have about banks' operations point to the conclusion that AML/CFT regulations and standards are not the main cause of inadequate risk mitigation and/or avoidance measures, but they may be a related factor, and improving AML/CFT measures with a focus on the proper implementation of the RBA should be part of the solution.

3. FINANCIAL EXCLUSION

The Agency is fully committed to supporting and promoting financial inclusion. Financial exclusion is a complex issue with a number of reasons why certain private individuals cannot access or use regulated financial services. The requirement to implement the RBA approach through the application of the proportionality principle is an essential part of the implementation of the AML/CFT regulations and standards adopted by the Agency. The AML/CFT regulations and standards are established so that banks can better allocate their resources to mitigate risks and thus minimize financial exclusion.

Misapplication of AML/CFT regulations and standards, and in particular the failure to apply the principle of proportionality that underlies the risk-based approach, can cause or worsen financial exclusion and lead to the retention or even increase of unregulated financial transactions outside the financial system of Republika Srpska, i.e. BiH. Requirements based on rules uniform for all clients increase obstacles to financial inclusion, as banks are unwilling to assume or mitigate AML/CFT risks by undertaking adequate identification and monitoring measures tailored to each individual client.

There are two main factors contributing to financial exclusion:

- implementation issues at the country or private sector level, leading to misapplication of the AML/CFT standards, and in particular a failure to use proportionality, which is central to the risk-based approach. The risk-based instruments within the standards (such as exemptions and simplifications) are underused by banks to expand financial inclusion, and
- the interpretation that simplified identification and monitoring measures are optional in low-risk situations, with banks over-applying the following measures:
 - enhanced identification and monitoring measures even in low-risk cases, and
 - refusing to execute cash payment transactions from private individuals even in cases where the transactions are low-risk.

Within each of these categories, there are various additional restrictions, hindrances, and requirements that prevent private individuals from achieving financial inclusion.

4. CONCLUSION

The analysis of banks' activities in implementing the RBA approach indicates that a significant number of banks still do not conduct adequate risk assessments of cash payment transactions in accordance with the risk-based approach. This means that banks, based on established inadequate interpretations and the same rules for all clients, apply the same measures to all clients, failing to use proportionality, which is central to the risk-based approach, while a smaller number of banks conduct a risk-based approach and monitoring.

In a significant number of cases, the measures undertaken by banks in the process of identifying and monitoring clients are not proportionate or focused, thereby affecting the legitimate activities of private individuals.

Inadequate treatment of cash transactions of private individuals in the context of the implementation of the AML/CFT standards in certain cases is associated with inadequate implementation of the RBA approach.

In response to the phenomenon that the excessive application of AML/CFT measures has a negative effect on the legitimate activities of private individuals, BiH, in early 2024, in the process of harmonizing the regulatory framework with AML/CFT standards, promoted a risk-based approach, with the aim of protecting clients from the excessive application of AML/CFT requirements, while ensuring that focused risk-based measures do not restrict or discourage clients' legitimate activities.

The safeguards that banks implement in the process of conducting transactions and establishing business relationships with private individuals should be targeted and in accordance with a risk-based approach. The application of excessive measures by banks and the refusal to execute the relevant transactions in cases where there is a lower level of risk do not constitute "*compliance with AML/CFT standards*", which may lead to the retention or even increase of unregulated financial transactions outside the financial system of Republika Srpska, i.e. BiH.

Adequate implementation of the RBA is a key element to remedy identified weaknesses, with a focus on implementing measures tailored to each individual client.

Banks should also fully implement the conclusions reached at the working consultative meetings of bank representatives and competent authorities, with a particular focus on implementing the conclusions on identifying the funding sources of low- and medium-risk clients.

In order to ensure adequate financial inclusion of every individual, banks should ensure records of clients' complaints, within which clients should be enabled to leave their observations and comments on measures by means of which banks prevent performance of services due to excessive application of AML/CFT requirements and inadequate application of the RBA approach.

5. FINAL PROVISIONS

These Guidelines shall enter into force on the eighth day from the date of their adoption and shall be published on the official website of the Agency.

Number: D-2/25

Date: 7 February 2025

Director

[duly signed and sealed]

Srđan Šuput