CUSTOMER DUE DILIGENCE AND FINANCIAL INCLUSION IN MALAYSIA: BALANCING REGULATORY MEASURES AND ACCESSIBILITY

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This article will critically analyse the substantial inadequacies of the current Customer Due Diligence (CDD) framework in safeguarding marginalised communities from financial exclusion in Malaysia. It will highlight that for vulnerable groups such as rural inhabitants, undocumented migrants and refugees, the CDD only impedes access to formal financial services as it is currently framed and applied. It will be argued that implementing a risk-based approach in CDD policies in Malaysia results in mere compliance with global standards of CDD. However, these standards fall well below what is required for these purposes of helping marginalised groups. In addition, there is evidence that banks are exhibiting over-cautious compliance behaviour, which resulted in banks hesitating to implement some of the CDD flexibilities introduced by the regulators. In order to address these problems and overcome the barriers, proposals to develop new CDD strategies are analysed. These include reducing documentation requirements, widening the list of acceptable documents and introducing entry-level accounts. The aim is to address banking access issues for these communities without compromising the regulatory objectives of CDD. It recommends that CDD regulations can better assist financial inclusion if tailored to the specific needs of the excluded communities with a risk-based approach.

Keywords: Customer due diligence, financial exclusion, undocumented migrants, banking access.

I. Introduction

The Central Bank of Malaysia Act[1] was amended in 2009 to grant the Central Bank of Malaysia or Bank Negara Malaysia (BNM) an explicit mandate to actively promote financial inclusion within the country[2]. Extensive efforts and reforms to banking for the unbanked[3] have taken place since then and were arguably fruitful[4]. However, bringing the remaining underserved fractions of society, particularly undocumented[5] individuals, comprising mostly migrants and refugees as well as rural communities[6], into formal financial services remains a challenge.

This article argues that the common challenge to accessing banking services amongst these communities is the satisfaction of the Customer Due Diligence (CDD) requirement mandated by the Malaysian AML/CFT regulations. The problem stems from the shortcomings of the CDD practices that led to the financial exclusion phenomenon in Malaysia. This article has identified two significant problems of the CDD, which are i) the ineffective implementation of the risk-based approach; and ii) the over-cautious implementation of the CDD policy practices by banks. This article argues that the solution

1 Central Bank of Malaysia Act 2009 (Act 701)

2 Section 5(2)(f) of the Central Bank of Malaysia Act.

3 The European Commission, in its 2008 report entitled 'Financial Services Provision and Prevention of Financial Exclusion' has defined 'unbanked' as those who are generally people with no bank at all; see European Commission, 'Financial Services Provision and Prevention Of Financial Exclusion' (2008).

4 In 2021, the Global Findex Database of the World Bank revealed that 88% of Malaysia's adults had an account at a formal financial institution, which is an increase of 7% from the 2015 data; see Asli Demirguc-Kunt and others, 'The Global Findex Database 2021: Financial Inclusion, Digital Payments and Resilience in the Age of COVID-19' (World Bank 2021).

5 In this context, "undocumented" does not necessarily mean a complete non-possession of identification document. An individual can also be classified as undocumented if his identification document is not recognized in the country and/ or the documents that he has is not sufficient to meet the requirements stipulated by the law.

6 Migrants, refugees and rural communities are identified in this research as the groups of population who are at most disadvantage in terms of access to finance. Refer to Paragraph III "Financial Exclusion in Malaysia" for a discussion on this matter.

to these problems is to ease regulations and tailor the regulations to the specific needs of the excluded communities with a risk-based approach.

This article is structured as follows: in the first part, the article explores the concept of financial exclusion and customer due diligence, focusing on the Malaysian context. The second part of the article delves deeper into how Malaysia's CDD rules contribute to financial exclusion for vulnerable individuals in society, such as rural populations, undocumented migrants, and refugees. The consequences of these CDD-related barriers are analysed, including the limitations on economic opportunities and overall well-being for marginalised communities. The third part explores potential solutions to address these challenges, emphasises the importance of finding a balanced approach to CDD and financial inclusion, and concludes with a call to action to create a more inclusive financial environment in the country.

II. Defining financial exclusion and financial inclusion

Bank Negara Malaysia (BNM), the central bank of Malaysia, assumes the responsibility of regulating and supervising financial institutions to ensure adherence to anti-money laundering and countering financing of terrorism (AML/CFT) regulations. Concurrently, financial inclusion stands as a significant objective in Malaysia, striving to grant access to financial services for all Malaysians, irrespective of their income level or location. Since the mid-1990s, the concepts of financial inclusion and exclusion have garnered considerable attention from academic researchers and policymakers on a global scale. Initially, the definition of financial exclusion centered around geographical factors, as described by Leyshon and Thrift, who defined it as the "processes that hinder the ability of economically disadvantaged individuals and marginalized social groups to access the financial system" primarily due to limited geographical access[7]. However, over time, the concept evolved into a more comprehensive understanding that encompassed additional barriers to access beyond the geographical context.

It has been argued that regulation can influence financial exclusion, as highlighted by the assertion made by Porteous and Zollman. They contend that certain regulatory requirements, such as the insistence on specific documentation or increased compliance costs, can unintentionally lead to the exclusion of particular groups[8]. Moreover, they suggest that banks themselves have implemented eligibility criteria that surpass regulatory mandates, resulting in the exclusion of certain segments of society, particularly those who are economically disadvantaged, such as individuals facing poverty[9].

A good example of this is the satisfaction of customer due diligence, a rule mandated by the AML/CFT regulation. The CDD requires customers to be verified and identified during the account opening process. In many countries without a compulsory identity card, some people have found it challenging to supply the types of identity banks required to open an account. The typical proof of identity documents acceptable for opening an account is a passport and driving license, which are uncommon amongst low-income communities[10].

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7 Andrew Leyshon and Nigel Thrift, 'The Restructuring of the U.K. Financial Services Industry in the 1990s: A Reversal of Fortune?' (1993) 9 Journal of Rural Studies 223; Andrew Leyshon and Nigel Thrift, 'Access to Financial Services and Financial Infrastructure Withdrawal: Problems and Policies' (1994) 26 Area 268.

8 David Porteous and Julie Zollmann, 'Making Financial Markets Work for the Poor' (2004) 27 Enterprise Development and Microfinance 5.

9 ibid.

10 HMRC, 'Your Responsibilities under Money Laundering Supervision' (*HM Revenue and Customs - Gov.uk*, 2017) 8 <https://www.gov.uk/guidance/money-laundering-regulations-your-responsibilities#record-keeping-requirements>.

The corresponding concept of financial inclusion varies in terms of its definition. While financial exclusion is commonly defined based on factors causing the phenomena, the definition of financial inclusion is usually discussed in the context of global and national visions of the desired state of financial inclusion. For example, the World Bank envisaged financial inclusion as "individuals and businesses have access to useful and affordable financial products and services that meet their needs"[11]. In the UK, financial inclusion is defined as "individuals, regardless of their background or income, having access to useful and affordable financial products and services"[12].

The types of financial services that should be considered in assessing financial exclusion are related to the concept of financial exclusion. In 2005, the World Bank indicated the four main types of essential services that individuals should have access to transaction banking, savings, credits and insurance[13]. Among these essential financial services, it is submitted that there is a hierarchy in terms of their importance, with banking accounts sitting on top of the ladder. While other financial products such as credits and insurance are undoubtedly important, the unavailability of a bank account implicates a more direct negative influence as it serves as the gateway to providing other financial services[14].

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11 World Bank, 'Financial Inclusion Overview' (2018) 4 <https://www.worldbank.org/en/topic/financialinclusion/overview> accessed 15 June 2019.

12 Timothy Edmonds, 'Financial Inclusion (Exclusion) Briefing Paper Number 01397' (2017).

13 World Bank, 'Indicators of Financial Access- Household -Level Surveys' 1 <http://siteresources.worldbank.org/FINANCIALSECTOR/539914-1118439900885/20700929/Indicators_of_Financial_Access_Household_Level_Surveys.pdf>.

14 Hue Dang, 'Financial Inclusion, Developing Economies and Effective Implementation of the Risk-Based Approach in AML/CTF: The Need for Legislative and Regulatory Leadership to Motivate Private Sector Commitment and the Role of Audit'.

Three conclusions can be drawn from the above. First, although the terms financial exclusion and inclusion have been defined in different contexts, they are essentially the opposite of each other and should be understood in this sense. Secondly, financial exclusion and/or financial inclusion can be defined in two tiers, access and usage. This article focuses on the first tier of financial inclusion, namely access, as this denotes the potential ability to use financial services, without which there could not be any usage. Thirdly, although all the basic financial services are important and play specific roles in the daily lives of individuals, it is submitted that the issue of financial exclusion should first be addressed in the context of the essential financial service, specifically banking transaction accounts. Therefore, the scope of this article is limited to accessing bank accounts, and financial exclusion is thus defined as limitations towards opening a bank account. In line with the scope of this article, the terms "financially excluded" and "unbanked" will be used interchangeably to refer to individuals without a bank account.

III. Financial Exclusion in Malaysia

An inclusive financial system aims to provide equitable access and usage of high-quality, affordable, and essential financial services to all individuals in society, particularly those who are underserved. This objective seeks to promote shared prosperity and ensure that everyone has the means to meet their financial needs effectively. The objective of financial inclusion in Malaysia is to create an inclusive financial system that benefits all members of society, with a particular focus on the "underserved "[15]. The data suggests that despite Malaysia's seemingly robust position in terms of financial inclusion policy,

15 BNM, 'Overview of Financial Inclusion in Malaysia' 1 <http://www.bnm.gov.my/index.php?ch=fi&pg=fi_ovr&ac=471&lang=en> accessed 14 October 2019.

an imperfect approach to this policy has resulted in about 9% to 15% of the country's adult populace being denied access to formal finance. Consequently, these individuals have ended up in groups that are "underserved"[16].

In the context of financial inclusion, underserved is usually referred to those who lack access to a formal bank account[17] and often include rural communities, women and undocumented migrants[18]. However, the term "underserved" has not been distinctly defined in Malaysia. This ambiguity fosters the belief that the country's financial inclusion policy is meant to be all-encompassing, essentially catering to both Malaysian citizens and non-citizens. Contrary to this assumption, the authors argue that to meet the financial inclusion goals set by Bank Negara Malaysia, it is essential for policies and initiatives promoting financial inclusion to be intentionally designed to serve every member of society, regardless of their Malaysian citizenship status.

However, financial inclusion policies in Malaysia frequently exclude non-Malaysian citizens[19]. A prime example is the Guidance to Basic Banking Services released by Bank Negara Malaysia, which clearly specifies that the entitlement to basic banking services is exclusively for Malaysian citizens and permanent residents[20]. This has significant

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16 Jose de Luna Martinez and Sergio Campillo-Diza, ‘Financial Inclusion in Malaysia: Distilling Lessons for Other Countries’ (2017).

17 Tracey Durner and Liat Shetret, ‘Understanding Bank Derisking and Its Effects on Financial Inclusion: An Exploratory Study’ (2015).

18 Louis De Koker, ‘Aligning Anti-Money Laundering, Combating of Financing of Terror and Financial Inclusion: Questions to Consider When FATF Standards Are Clarified’ (2011) 18 Journal of Financial Crime 36 1.

19 Bank Negara Malaysia, ‘Guide Basic Banking Services.Pdf’ <https://www.bnm.gov.my/documents/20124/55792/basic_banking_services.pdf>.

20 Refer to Section VII “Customer Due Diligence and Financial Exclusion in Malaysia” for a discussion on how the CDD practices in Malaysia creates a challenging environment for the underserved communities to access banking accounts in the country.

repercussions as these stipulations effectively disqualify non-Malaysians, especially undocumented immigrants and refugees, from access to banking services within the country. The rigorous customer due diligence process and identification system also present a formidable obstacle for migrant workers and refugees to gain banking access, as it restricts the beneficiary range exclusively to Malaysians[21]. Furthermore, there is a lack of legal instruments to incentivise or mandate banks to accept these communities as their customers, which ultimately leaves the decision solely at the discretion of the banks themselves as to whether or not to provide them with service[22].

The following section further elaborates on the "underserved communities" and explain how they are excluded from formal finance in Malaysia. These communities are the rural communities, undocumented migrants and refugees.

A. Rural Communities

The rural hinterlands of Malaysia are home to almost 23% of the Malaysian population[23]. Here, rural communities do not merely refer to aborigines living in rural areas, although aborigine settlements can be considered severely isolated[24]. Rural communities also connote those living in secluded areas of Malaysia with distinct infrastructure deficits and costly transport to commute outside their vicinity.

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21 Refer to Section VII (A)(1) “Problems in Simplified Due Diligence” for a detailed discussion on this matter.

22 Refer to Section VII(B) “Over-cautious implementation of CDD” for a discussion on this matter.

23 Murray Hunter, ‘Reinvigorating Rural Malaysia - New Paradigms Needed.’ [2013] *New Mandala*.

24 For example, it takes almost 5 hours to reach Kampung Cenan Cerah in Pahang, Malaysia from the main motorway in Ringlet. From Ringlet, Pahang, one will need to take a 4x4 drive for about two hours, then continue the journey to the village via walking, motorcycle or via boat.

The proximity of financial services significantly impacts customer engagement. For effective engagement, it is crucial that bank branches, which serve as the initial point of contact for potential customers, are conveniently accessible to all communities. However, in Malaysia, numerous areas, especially rural regions, lack the presence of bank branches[25]. This poses a challenge as the nearest bank branches are often located miles away, exacerbating the issue. Additionally, the lack of convenient transportation further complicates the situation, making it difficult for residents to commute to the local town where the nearest bank branch is situated. For example, villagers from Kampung Mat Daling in rural Pahang, Malaysia, must travel almost 128km to reach the nearest physical bank branch in the main town, Jerantut[26]. The main transportation service that could commute villagers to the nearest town is by boat, which alone takes 4-5 hours[27]. The alternative transportation is by timber trucks which have to be rented at the cost of RM70 peruse[28], which is the cost of roughly 7 meals in Malaysia.

It is worth noting that a significant development has taken place in rural Malaysia where most areas previously lacking bank branches are now served by agent banks[29]. This initiative, spearheaded by the government, aims to enhance banking outreach to rural regions. Licensed financial institutions have been granted the opportunity to appoint existing businesses, including retail outlets and post offices, as their agents. These agents are now able to provide basic banking services such as cash withdrawals, transfers, and

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25 Only 46% of sub-districts in Malaysia are served by bank branches. See de Luna Martinez and Campillo-Diza (n 16).

26 Su Lin Tan, 'Derita Ulu Tembeling: Sungai Kering, Pengangkutan Utama Lumpuh.' Astro Awani (Jerantut, 13 April 2016).

27 ibid.

28 ibid.

29 de Luna Martinez and Campillo-Diza (n 16).

bill payments. The agent bank initiative is widely recognized as one of the key contributors to the expansion of financial services in Malaysia, particularly in rural areas.

It is seen as an all-rounder solution that provides all parties with basic financial access. For retailers, agent banks add to their income through commissions gained from transactions and increased traffic to their business. Establishing agent banks is a much cheaper alternative for financial institutions than setting up a traditional bank branch[30]. While traditionally, agent banks are allowed to offer basic services such as cash withdrawal, and bill payment, the role of account opening was only allowed recently, in 2010, five years after its initiation. Even then, under the current regulation, agent banks are only allowed to facilitate account opening[31] but cannot conduct full CDD to complete the process[32]. Rural communities, thus, still need to commute to a bigger town where the bank branch is located. CDD can be seen as a significant barrier to account opening, particularly for rural communities, given the distance and lack of public transportation for commuting. Thus, it is arguable that banking sector outreach remains low for Malaysia as agent banks cannot be regarded as effective bank branches due to their limitations in opening a bank account for customers.

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30 Bank Simpanan Nasional, the pioneer of agent banking in Malaysia testifies that setting up agent banks requires less than 1% than what it normally spends in setting up traditional bank branches. See, Cordeli Mason, Raymond Madden and Ho Jo Ann, 'Bank Simpanan Nasional: Pioneering Financial Inclusion in Malaysia' (2016).

31 Bank Negara Malaysia, 'Agent Banking' (2015) <http://www.bnm.gov.my/guidelines/08_agent_banking/01_agent_banking_20150430.pdf>. Hereinafter referred to as "Agent Banking Guideline Malaysia 2015", Rule 12.2(i).

32 Rule 8.9 of Agent Banking Guideline Malaysia 2015 (n 31)

B. Undocumented migrants

In Malaysia, migrants are typically classified into two main categories: expatriates and non-expatriates. Expatriates refer to individuals equipped with high-level skills who enter Malaysia to contribute professionally in technical and administrative fields. Conversely, non-expatriates, hereafter referred to as "foreign workers," consist of low or semi-skilled workers whose occupations are predominantly found within certain sectors like domestic work, construction, and plantations. These foreign workers can be recruited through legal means or otherwise, and it's worth noting that many who were legally recruited often become undocumented due to overstaying their visas or absconding from their employers.[33] In addition, there are individuals who initially entered Malaysia through illicit means, but subsequently attained legal status via amnesty or naturalization programs rolled out by the government.

The primary focus of this article is on the non-expatriate migrant population. While expatriates, usually professionals, are generally well-supported by their employers and seldom face challenges concerning documentation or access to banking services, the same cannot be said for non-expatriates. According to the World Bank, by the end of 2017, the number of non-expatriate migrants in Malaysia was estimated to be between 2.96 and 3.26 million,[34] constituting roughly 23% of the country's workforce. Out of these, an estimated 1.23 to 1.46 million are undocumented[35]. However, there are debates regarding the potential undercounting of migrants in Malaysia. Therefore, a tentative estimation made by Lee and Khor suggests that the total number of migrants in Malaysia could reach

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33 Kassim Azizah, 'Integration of Foreign Workers and Illegal Employment in Malaysia', *International Migration in Asia: Trends and Policies* (2000).

34 Wei San Loh and others, 'Malaysia: Estimating the Number of Foreign Workers (A Report from the Labor Market Data for Monetary Policy Task)' (2019).

35 ibid.

as high as 5.05 million,[36] with over 2 million potentially being undocumented[37]. These migrants hail from a range of countries, with the majority originating from Indonesia, Bangladesh, and Nepal, while a smaller fraction comes from countries like Vietnam, the Philippines, and India.[38].

The rights of migrants to possess a basic bank account in Malaysia are significantly limited, even for those legally employed. The most basic financial products are only available to Malaysians and permanent residents of Malaysia. While Malaysians and permanent residents are accorded the right to a basic account, migrant workers are explicitly excluded from enjoying the same[39]. For migrant workers with valid documents, the documents required to open a bank account are complex and often beyond the reach of these migrant workers. The common documents are a passport, a valid working permit and a visa, and employers commonly withhold these[40] to prevent abscondment[41]. Other documents also include reference letters from employers, sometimes requiring employers to be present in the account opening process. For migrant workers without valid documents, the chances of getting a bank account are limited as they would have insufficient documents to identify and verify themselves, particularly documents verifying the legality of their stay in the country.

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36 Lee Hwok-Aun and Khor Yu Leng, 'Counting Migrant Workers in Malaysia: A Needlessly Persisting Conundrum' [2018] ISEAS Perspective 1 <https://www.iseas.edu.sg/images/pdf/ISEAS_Perspective_2018_25@50.pdf>.

37 Amnesty International, 'Trapped: The Exploitation of Migrant Workers in Malaysia' [2010] Human Rights <www.amnesty.org>.

38 Syarisa Yanti Abubakar, 'Migrant Labour in Malaysia: Impact and Implications of the Asian Financial Crisis.' [2002] EADN Regional Project on the Social Impact of the Asian Financial Crisis.

39 Bank Negara Malaysia (n 19).

40 A Memorandum of Understanding signed between Malaysia and Indonesia MoU between Indonesia and Malaysia in 2008 also allows employers to retain the passports of domestic Indonesian workers, confining the workers within the employers' homes.

41 Amnesty International (n 37).

C. ***Refugees***

The exact population size of refugees in Malaysia is difficult to estimate. The United Nations High Commissioner of Refugees ("UNHCR") states that as of the end of August 2019, the number of registered refugees is 177,690[42] and acknowledges that there are many more unregistered[43]. The majority of refugees in Malaysia came from Myanmar to escape from the discriminatory and inhumane treatment they received back in their country[44]. Malaysia attracts many refugees, particularly those from Muslim countries, because it is Muslim-majority[45] and because it is one of the very few countries accepting citizens visa-free from middle eastern countries in conflicts, such as Syria and Yemen[46]. The existence of the refugee community in Malaysia also influenced the decision of many others to come to Malaysia due to the perceived ease of networking and settling down[47].

One of the significant challenges faced by refugees worldwide is the issue of identification. Often, when fleeing their countries, refugees are unable to carry any identification documents. These documents may have been inadvertently left behind, lost, destroyed, or even stolen during their arduous journey[48]. In the case of Rohingyans from Myanmar, they often arrive in Malaysia without any form of identification, as they were

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42 UNHCR, ‘Figures at a Glance in Malaysia’ (2019) 1 <https://www.unhcr.org/uk/figures-at-a-glance-in-malaysia.html> accessed 7 October 2019.

43 Eric Paulsen, ‘The Future for Refugees in Malaysia’ [2019] The Star Online <https://www.thestar.com.my/news/nation/2019/06/16/the-future-for-refugees-in-msia>.

44 Amnesty International, ‘Abused and Abandoned: Refugees Denied Rights in Malaysia’ (2010).

45 Overseas Development Insitute, ‘Livelihood Strategies of Rohingya Refugees in Malaysia’ <https://www.odi.org/publications/10449-livelihood-strategies-rohingya-refugees-malaysia>.

46 Teo Kermeliotis, ‘ We Have Nothing ’: A Life in Limbo for Malaysia ’ s Yemeni Refugees’ (AlJazeera, 2019) <https://www.aljazeera.com/news/2019/03/life-limbo-malaysia-yemeni-refugees-190324110354467.html>.

47 Overseas Development Insitute (n 45).

48 GSMA, ‘Refugees and Identity:Considerations for Mobile-Enabled Registration and Aid Delivery’ (2017) <gsma.com/mobilefordevelopment/wp-content/uploads/2017/06/Refugees-and-Identity.pdf>.

unable to obtain one from the government in their home country[49]. Similarly, Syrians have faced tremendous difficulties in replacing or applying for identity documents since the outbreak of the civil war. Compounding the issue, the so-called Islamic State has deliberately sought to destroy passports and legal records of Syrian civilians[50]. For refugees in Malaysia, the UNHCR card becomes the primary, and in many cases, the only document available to prove their identity and legal status within the country. However, this card is problematic when opening a bank account for two reasons: first, the card is not legally recognised in Malaysia; secondly, obtaining the card itself is a very challenging process for the refugees.

Concerning the first point, it should be noted that the UNHCR is not legally recognised in Malaysia due to the fact that Malaysia has not signed the 1951 United Nations Convention relating to the Status of Refugees nor its 1967 Protocol. As a result, Malaysia is not bound to comply with any of the provisions outlined in the Convention, including those that stipulate the primary responsibility of host countries to register refugees and provide identification papers to refugees who lack valid documentation.

In response to the challenge, the UNHCR has assumed the complete responsibility for registering and identifying refugees in Malaysia.[51] They compile records of the refugees' identities and issue them a UNHCR card, which facilitates access to services provided by the UNHCR and offers discounted healthcare at government hospitals[52]. However, it is important to note that the UNHCR card holds no legal value in Malaysia. It signifies that

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49 Overseas Development Insitute (n 45).
50 GSMA (n 48).
51 Overseas Development Insitute (n 45).
52 UNHCR, ‘REGISTRATION’ (2017) <https://www.unhcr.org/uk/registration-59e036674.html> accessed 21 January 2023.

the cardholder receives a certain level of protection from the UNHCR and is granted limited access to public healthcare services[53]. Nevertheless, when it comes to opening a bank account, the UNHCR card is not considered an acceptable document for verifying identity[54]. According to the Overseas Development Institute, only one bank[55] has allowed certain registered refugees to open bank accounts at specific branches with the provision of a personalized letter from the UNHCR[56].

In relation to the second point, securing a UNHCR card is a highly challenging task, largely due to the agency's limited funding. This financial constraint has significantly limited the organisation's capacity to effectively respond to the current influx of refugees in the country[57]. The process for registration lacks a standardised procedure[58]. The prevalent method involves refugees sending faxes or letters containing their identification details and a photograph to UNHCR; however, there is no system in place to track whether their communication has been received or responded to[59]. This predicament leaves refugees in a state of uncertainty. It is not that they necessarily lack identification documents, but the existing system does not permit them to obtain one. If the government does not address this issue, the prospect of this community gaining access to banking services is virtually non-existent.

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53 ibid.

54 Most banks do not accept the UNHCR card as a valid proof of identity. See Annex 1 for list of acceptable documents for CDD.

55 The name of the bank and the specific branch is however not disclosed in the report.

56 Overseas Development Insitute (n 45).

57 UNHCR, ‘Identity Documents for Refugees’ <https://www.unhcr.org/en-my/excom/scip/3ae68cce4/identity-documents-refugees.html>.

58 Overseas Development Insitute (n 45).

59 Overseas Development Insitute (n 45).

IV. Why financial inclusion matters?

It is widely recognised that financial inclusion brings about economic advantages for individuals across the board. Specifically, for migrants, gaining access to banking services offers numerous benefits, including safer alternatives to cash, improved access to credit facilities, and reduced fees for international money transfers. The overall level of financial access serves as a significant indicator of the economic and social well-being of society as a whole[60].

Furthermore, the expansion of financial inclusion to these communities aligns with the objectives of Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) regulations. The Financial Action Task Force ("FATF")[61] has expressed a keen interest in financial inclusion, as it believes that pursuing financial inclusion complements its goals of maintaining financial integrity[62]. The underlying hypothesis is simple: by promoting financial inclusion, the scope of AML/CFT control can be broadened, thereby strengthening financial integrity. Financial inclusion encourages greater utilization of the formal financial system, enabling regulators to monitor a larger proportion of transactions conducted within that system. Conversely, financial exclusion is viewed as a risk to financial integrity, as it leads to a larger unmonitored financial sector. This lack of oversight deprives regulators of a crucial strategy in AML/CFT regulation, which is the ability to trace the movement of money.

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60 Anna Paulson and others, ‘Financial Access for Immigrants : Lessons from Diverse Perspectives’ <http://www.brookings.edu/~/media/research/files/reports/2006/5/demographics paulson/20060504_financialaccess.pdf>.

61 The FATF is the global standard setter for Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT) regulations. It makes recommendations which constitutes minimal standards in the fight of money laundering and terrorist financing.

62 FATF, Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion - With a supplement on Customer Due Diligence' (2013-2017)

Financial inclusion for migrant and refugee communities also represents a growth opportunity for the banking sector. Considering the substantial number of migrants and refugees in Malaysia, which totals over 5 million, integrating these individuals into the formal economy could significantly boost economic growth. This is because, when migrants and refugees engage with the formal financial system in their host countries, their earnings contribute to these economies rather than just their countries of origin[63]. These individuals could become customers for a range of financial products, including traditional offerings like savings accounts. More importantly, they could make use of international money transfer services, offering significant potential advantages to financial service providers[64].

As detailed in the paragraphs above, financial inclusion supports financial integrity objectives by encouraging a greater number of people to transact within the formal financial system. This expansion allows regulatory bodies to oversee an increased number of transactions occurring within the financial sector. In contrast, financial exclusion is perceived as a risk to financial integrity as it results in a larger, unmonitored financial sector. This scenario deprives regulators of a key strategy in the Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) regulation, which is the ability to trace the movement of money.

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63 E Kelly Sonja, 'Financial Inclusion …For Whom ? Considering Immigration and Citizenship' [2014] Center for Financial Inclusion.

64 Paulson and others (n 60).

At this juncture, it is crucial to reiterate that financial exclusion in Malaysia is predominantly an issue among non-citizens who reside in the country without proper legal status. Given this context, critical questions arise, such as why these communities need to be assisted, whether government intervention is necessary, and whether these efforts might inadvertently incentivise further illegal migration. These questions warrant careful consideration.

An essential argument that warrants attention is the significance of the financial exclusion issues among these communities due to their substantial presence in the country[65]. Including these groups within the banking system is not only profitable for the country but also safeguards the banking system from the growth of informal banks, which could pose devastating effects on the financial infrastructure. The persistent presence of irregular migrants and refugees in the country implies that numerous factors contribute to the problem of illegal migration in Malaysia. The current practice of excluding these communities has not proven effective in reducing their numbers, nor has it been shown to deter them from residing in the country. This fact necessitates a reevaluation of the policies and perhaps indicates it's time for the government to consider a more "deserving approach"[66] towards managing these communities.

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65 It was argued above that an estimated 1.23 – 1.46 millions of undocumented migrants are present in the country. The estimated number of refugees present in the country is approximately 180,000. See Section III (B) "Undocumented Migrants" and Section III(C) "Refugees".

66 The deserving approach to migration have been adopted in certain municipalities in European countries where undocumented migrants are primarily considered as "foreign workers who have not been able to enter legally or to possess identification documents, even though there is a need for them in the local economy". With this approach, more inclusionary policies have been applied to undocumented migrants in the form of access to healthcare, education and access to banking. The aim of this approach is to make available some crucial public services to the communities in view of their need in the local economy. See Nicola Delvino, 'European Cities and Migrants with Irregular Status: Municipal

However, it is not the assertion of this research that irregular migrants should be granted rights per se, as such allocation of rights would require a much broader evaluation, which is beyond the purview of this research. Whether the financial inclusion of these communities would trigger a surge in illegal migration in the country is another discussion that requires a broader context, which is also outside the scope of this article. This article solely posits that, given the context of banking access in Malaysia, there's a compelling case for the government to intervene and extend its support to these communities, despite their undocumented status.

V. Customer Due Diligence Requirements in Malaysia

The two most significant problems financial institutions face today are money laundering and terrorist financing[67]. The magnitude of these has grown significantly over recent years, particularly with the rapid developments in the information, technology and communication industry, which enhances the speed and ease with which money can move around the world[68]. In Malaysia, the CDD responsibilities are encapsulated in the Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities 2001 Act 2001 (Act 613). It encompasses three obligations: to ascertain the customer's identity, verify the information provided by customers and conduct ongoing monitoring. These obligations will be further discussed below.

Initiatives for the Inclusion of Irregular Migrants in the Provision of Services. Report for the "City Initiative on Migrants with Irregular Status in Europe" (C-MISE).'

67 Dennis Cox, Handbook Of Anti Money Laundering (Wiley 2014).

68 UNODC, 'Money-Laundering And Globalization' (Unodc.org) <https://www.unodc.org/unodc/en/money-laundering/globalization.html> accessed 23 May 2018

A. Ascertaining Identity

As the first step of CDD, financial institutions are required to ascertain the customer's identity by collecting relevant identity information[69]. The main goal of the CDD is to identify the natural person who is ultimately in control of the account, including the individual himself or, for corporate accounts, those holding senior management positions of the corporate organisation[70].

The FATF Recommendations do not establish specific requirements regarding the identification data to be collected or how identity should be verified. Malaysia takes a conservative view of what constitutes identity elements. It follows international guidelines, specifically the *BCBS's Sound Management of Risks related to Money Laundering and Financing of Terrorism,*[71] in determining the types of information to be collected. The risk-based approach[72] adopted also means that the types of information needed to vary according to the categories of the risk profile that a customer falls under.

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69 Section 16(3)(a) AMLATFPUAA

70 Section 14A.9.6 of BNM Guideline on Anti Money Laundering, Countering Financing of Terrorism and Targeted Financial Sanctions for Financial Institutions (hereinafter referred to as BNM Guideline 2019). It is noted that the extension of CDD requirement to those holding senior management position did not exist until recently. See the case of Ab Jabar Ab Rahman dan 2 Orang Perayu Lain v Kuwait Finance House (Malaysia) Sdn Bhd, Award No. 936 of 2018 where the Court decided that CDD rules were not breached when the Appellant failed to conduct CDD on a general manager of a company, even though he was admittedly the key person in control of the company and had the authority to secure significant transactions for the company. This decision implied that the concept of beneficial owners in the context of CDD were previously solely confined to directors and shareholders, irrespective of the actual control of the company.

71 Basel Committee of Banking Supervision, 'Guideline On Sound Management Of Risks Related To Money Laundering And Financing Of Terrorism' (Bank for International Settlements 2016)

72 The risk-based approach originates from Recommendation 1 of the FATF Recommendations which suggest that countries design their national AML/CFT rules based on a process of identification, categorisation and appropriate assessment of risk. The idea is for the rules to be adopted in proportionate to the risk assessed. Refer to Section VI(A) “Ascertaining Identity” below for a discussion on the implementation of the risk-based approach in CDD laws in Malaysia.

The procedure now is for financial institutions to have three CDD processes in place, namely the simplified, standard, and enhanced CDD, so that customers will only be subjected to the CDD process corresponding to their assessed risk. Therefore, financial institutions must identify whether the customer falls under the standard, high or low-risk categories before determining which CDD should be conducted on them.

The Guidance document on implementing a risk-based approach from Bank Negara Malaysia (BNM) explains the categorisation of customers based on their risk factors, which then determines their risk rating and the appropriate Customer Due Diligence (CDD) procedures to apply[73]. Simply put, the guidelines imply that only Malaysian citizens with a net worth of less than RM500,000 can be classified as low-risk and thus qualify for simplified CDD. While the guidance document attempts to categorise individuals from low-risk countries as "low-risk individuals", it's notable that the guidelines do not provide a clear definition of what constitutes a low-risk country. The illustration also stated that the risk rating for individuals originating from Singapore is a "medium" rating, noting that Singapore is neither a high-risk jurisdiction nor a neighbour to one. If a country as impregnable as Singapore [74]in the context of money laundering and terrorist financing is considered a "medium" risk, it is improbable that other countries can attract a lower risk rating where money laundering and terrorist financing is concerned. Regarding high-risk customers, the guidance specified that individuals with a net worth of more than RM3 million, politically exposed persons and individuals from high-risk or

73 Appendix 1 of BNM Guideline Malaysia.

74 Noting that Singapore is not listed as high-risk or sanctioned jurisdictions under the FATF and that it is rated compliant and largely compliant in most of the FATF Recommendations, see FATF and APG, ‘Anti-Money Laundering and Counter-Terrorist Financing Measures Mutual Evaluation Report: Singapore’ (2016).

sanctioned countries should be considered high-risk and be subjected to enhanced due diligence.

The key distinction between standard, simplified, and enhanced Customer CDD largely hinges on the extent of information required and the specific objectives of the CDD process. The data collected through CDD aims to enable financial institutions to familiarize themselves with their customers and gain a basic understanding of their financial behaviour.

Standard CDD, which requires nine points of information, exemplifies this intent. Certain data such as full name, NRIC or passport number, mailing and residential address, date of birth, and nationality are collected primarily to establish the customer's identity. Conversely, information related to the customer's occupation, employer's name or nature of business, and the purpose of transactions is gathered to give financial institutions a general understanding of the customer's financial behaviour[75].

In the context of simplified Customer Due Diligence (CDD), the focus seems to be merely on recording basic customer information rather than gathering data related to financial behaviour. Hence, financial institutions are only obligated to collect five key pieces of information: the customer's full name, their Malaysian identity card (MyKad) number or passport/reference number of any other official documents, residential address, date of birth, and nationality[76]. Finally, the enhanced CDD process intends to gather more information from customers to mitigate the higher risk involved. The additional

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75 Section 14A.9.1 of BNM Guideline Malaysia.
76 Section 14A.10.3 of BNM Guideline Malaysia.

information, such as volumes of assets, source of wealth and source of funds, must be collected on top of the standard nine-information CDD points and shall enable closer scrutiny of the account so that any peculiarities in transactions can be detected promptly[77]. Further, the rules also mandate that the decision on whether to resume a business relationship with a high-risk customer following enhanced CDD must obtain approval from senior management[78]. This places responsibility on senior management, who would have more expertise in this matter compared to the regular frontline bankers normally in charge of the standard CDD, so any irregularities in this process can be implicated upon them.

*B. **Verifying Identity***

The second step of CDD process mandates the verification of all information provided during the identification stage. This includes inspecting the original documents and maintaining their records[79]. The significance of this process was underscored in the case of Tele-Temps Sdn Bhd & Satu Lagi v Southern Bank Berhad[80]. In this case, a bank was deemed negligent for failing to verify the information provided by an individual who used two documents with conflicting address spellings to open an account. Despite the discrepancies, the bank overlooked the issue, assuming it was a mere technical error, and proceeded to deposit RM100,000 into the account. This negligence facilitated a fraudulent scheme.

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77 Section 14A.12.1 of BNM Guideline Malaysia.

78 ibid

79 Bank Negara Malaysia, ‘Guidance on Verification of Individual Customers for Customer Due Diligence Anti-Money Laundering, Countering Financing of Terrorism and Targeted Financial Sanctions for Financial Institutions, Designated Non-Financial Businesses and Professions and Non’ (2020) <https://amlcft.bnm.gov.my/document/DNFBP/faq/03.Guidance_on_Verification_01092020.pdf> accessed 6 July 2021 (“BNM Guidance on Verification”)

80 Rayuan Sivil No. R3-12B-401-2009.

The court stressed the bank's crucial role in verifying information, noting that even minor discrepancies, such as the inconsistent address spellings, can lead to substantial adverse consequences - in this instance, a fraud-induced loss for the appellant. The bank should have regarded the inconsistency as a potential red flag, prompting further due diligence, such as cross-referencing with public databases or conducting a personal interview. Such measures could have helped prevent the fraud.

This case is particularly relevant in the context of Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) regulations, where the verification process is critical to ensuring the accuracy of customer information. Therefore, banks are strongly advised to refer to the original documents when verifying a customer's identity and to keep records of these documents.

As a basic principle, the provisions under the AMLATFPUAA 2001 and the guidelines indicate that the verification process should normally be completed before any business relationship is established or the transaction completed. However, Section 14A.10.5 of the guideline allows verification to be delayed for not more than 10 working days or any other period as may be specified by BNM after the business relationship commences[81]. This can occur in certain circumstances where the ML/TF risks are assessed as low, and verification is not possible when establishing a business relationship. The guideline does not provide further illustrations as to the situations that could apply the delayed verification process; thus, the applicability of this provision remains uncertain to date. Besides, delayed verification is also allowed in the context of accounts opened at agent

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81 Section 14A.10.5 of BNM Guideline Malaysia.

banks, whereby such accounts may be "fully verified" at the main bank branch within two months from its opening[82].

The most important issue in the context of the verification process is the types of documents acceptable to verify the identity of a customer. The primary criteria for acceptable documents are that they must be independent and reliable[83]. "The BNM further defines "Independent document" as documents "… issued or made available by an official body… even if they are provided to the reporting institutions by or on behalf of that person."[84]

The element of reliability in a document is closely tied to its acceptability in different contexts. For instance, BNM stipulates that a reliable document should be one that enjoys widespread recognition and acceptance by both the government and private sectors in Malaysia for identification purposes and authorization of other services. Evidently, the documents with the highest degree of independence and reliability are those issued by national governments, local authorities, and regulated entities in the financial sector and utility companies within the country. If a document includes a photograph, it increases its reliability; however, documents without photos can still be accepted if another supporting document corroborates them.[85] The main documents that can be used for verification are specified as *"... identity card (or the MyKad), passport, driver's license, constituent*

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82 Agent Banking Guideline Malaysia 2015 (n 31)

83 Section 16(3)(b) of AMLATFPUAA 2001; and Section 14A.5 of the BNM Guideline Malaysia

84 Section 3.5 of the BNM Guidance on Verification (n 79).

85 Examples of documents that can be used as supporting documents are current bank statements used by banks licensed and incorporated in Malaysia, current utility bills for specific duration and quit rent and assessment notice issued by state municipal councils. See BNM Guidance on Verification (n 79).

document or any other official or private document as well as other identifying information relating to that person"[86].

The Guidance on Verification and CDD further adds that for foreigners, banks are recommended only to accept a valid foreign passport issued by a foreign government and, if applicable, a visa to enter Malaysia[87]. It is also interesting to note that the guidance has specifically mentioned the situation of refugees, wherein it stated that banks should consider accepting refugees with a document, a letter or a statement from the United Nations or its agents, such as the UNHCR card[88]. Further, the guidance also allows for CDD to be completed by way of recommendation by another "appropriate person"[89] who knows the individual to verify that the person is who he says he is[90]. In practice, most banks will accept the National Registration Identification Card (also commonly known as MyKad) as the primary verification document for Malaysian citizens and a valid passport for non-citizens. It is also common for banks to request additional[91] supporting documents, such as a copy of utility bills or employment letters, to verify other customer information, such as address and employment information[92].

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86 ibid.
87 Section 5.6 of BNM Guidance on Verification (n 79)
88 ibid.
89 Appropriate person is not defined in the Guidance, leaving doubts as to the criteria of the person who can make such verification. It is arguable that this doubt may lead banks to exhibit over-cautious behaviour and choose not to exercise or to impose overly strict requirements to exercise this flexibility. See Paragraph VII(B) “Over-cautious compliance behaviour”.
90 BNM Guidance on Verification (n 79)
91 Except in situations where the main document presented is a document that does not bear the photograph of the customer, the request of additional documents for verification is not stipulated neither in any of the policy documents issued by the BNM nor the AMLTFPUAAA itself. We argued that the practice of requesting additional CDD documents is evidence of the over-cautious behaviour practiced by banks. See Paragraph VII(B) “Over-cautious compliance behaviour”
92 The request of employment information is not stipulated in any of the policy document is not stipulated neither in any of the policy documents issued by the BNM nor the AMLTFPUAAA itself. We argued that this practice is evidence of the over-cautious

C. ***Ongoing Monitoring***

Ongoing monitoring of an account signifies the requirement of financial institutions to maintain CDD over the lifetime of a relationship with the customer[93]. This is to consider that a customer who passes the original CDD may subsequently engage in money laundering or terrorist financing. The obligation to conduct ongoing monitoring is provided under Section 16(4) of the AMLATFPUAA 2001 and further reinforced in Section 14A.13 of the BNM Guidelines. The ongoing monitoring responsibility involves the bank making sure that transactions being conducted by customers are consistent with the bank's knowledge of the customer. Banks must also ensure that all documents, data or information collected under the CDD process are kept up-to-date and relevant. Consistent with international standards, the extent of ongoing monitoring in Malaysia shall be risk-sensitive and commensurate with the level of ML/TF risks the customer poses. For customers with a high-risk profile, the frequency of monitoring must be enhanced, and specific patterns of transactions must be closely monitored so that any possibility of unusual transactions can be promptly alerted.

VI. Customer due diligence and financial exclusion in Malaysia.

In Malaysia, a key reason for financial exclusion across various groups relates to the CDD policies stipulated by Anti-Money Laundering/Countering the Financing of Terrorism

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behaviour exhibited by banks and may be problematic for financial inclusion. See Paragraph VII(B) “Over-cautious compliance behaviour”

93 Norhashimah Mohd Yasin and Mohd Yazid Zul Kepli, Anti-Money Laundering and Counter Financing of Terrorism Law in Malaysia (1st edn, Lexis Nexis 2018).

(AML/CFT) regulations. Numerous global studies have demonstrated the direct link between CDD requirements and financial exclusion[94]. This article identifies two primary issues with CDD that contribute to financial exclusion in the country: i) the ineffective implementation of the risk-based approach, and ii) the overly cautious execution of CDD policy practices by banks.

A. Implementation of the risk-based approach

The FATF Recommendations suggest that countries design their national AML/CFT rules based on a process of identification, categorisation and appropriate assessment of risk[95]. In the context of financial inclusion, this means that individuals or entities assessed with lower risk should be subjected to lower measures of customer due diligence, including a lower threshold of identification, flexibility in verification and a less rigorous monitoring mechanism[96] and vice versa[97]. Importantly, being financially excluded does not equate to a lower risk[98]. Hence, applying any RBA measures must necessarily be based on a holistic risk assessment at the national, institutional and individual levels[99]. Before 2019, the RBA in Malaysia had not been given any statutory footing. There was

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94 See for example, Elaine Kempson and others, ‘In or out? Financial Exclusion: A Literature and Research Review.’ 265; Hennie Bester and others, ‘Implementing FATF Standards in Developing Countries and Financial Inclusion : Findings and Guidelines’ <http://dro.deakin.edu.au/view/DU:30016859>.; Peter J Morgan and Naoyuki Yoshino, 'Overview Of Financial Inclusion, Regulation And Education.', Financial Inclusion, Regulation and Education: Asian Perspectives (1st edn, Asian Development Bank Institute 2017); Center for Global Development, 'Financial Regulations For Improving Financial Inclusion: A CGD Task Force Report' (Center for Global Development 2016)

95 Recommendation 1 of FATF Standards, FATF, ‘International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations.’ <www.fatf-gafi.org/recommendations.html>.

96 ibid

97 Entities identified and assessed as higher risk should be subjected to higher threshold of customer due diligence; ibid.

98 FATF, ‘International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations’ (n 95).

99 ibid.

no provision of the RBA under the main Act governing money laundering and terrorist financing activities. The provision of the RBA under BNM's Sectoral 1 Guideline was vague and did not provide any clear policy expectations with regard to the RBA. Five years after the issuance of the Sectoral 1 Guideline, BNM issued a technical note to assist financial institutions in designing AML/CFT controls that align with the RBA strategy.

The recent issuance of the new AML/CFT policies by BNM saw some significant changes being made, particularly towards advancing the risk-based approach in the Malaysian AML/CFT laws. Within this framework, three categories of due diligence are finally introduced: simplified, standard and enhanced due diligence[100]. The policy is supplemented by guidance on the risk-based approach, which clarifies the understanding and policy expectations of the RBA. It also provides illustrations on risk parameters and clear guidelines on how financial institutions should conduct risk scoring and risk profiling to assist them in deciding which risk categories the customer should fall into and, subsequently, which CDD measures the customer should be subjected to. In Malaysia, the risk-based approach is manifested in three policies: simplified due diligence for accounts opened at agent banks, delayed verification, and tiered accounts. However, several issues identified within these frameworks have arguably led to communities being financially excluded in the country.

1. *Problems in Simplified Due Diligence in Malaysia*

The strategy employed by Malaysia seeks to minimise the extent of identification information required during the account opening process. The first issue arises from the

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[100] Refer to Part VI (A) “Ascertaining Identity” for a discussion on the rules relating to simplified, standard and enhanced due diligence.

Risk-Based Approach Guidance issued by the Central Bank of Malaysia[101]. This guidance implicitly permits simplified due diligence to be conducted solely on Malaysian citizens with a net worth of less than RM500,000[102]. Consequently, this restricts the accessibility of simplified due diligence easements to the financially excluded groups, specifically undocumented individuals and refugees.

Secondly, the simplified CDD applies only to the identification process, not the verification process[103]. The flexibility introduced in Malaysia has merely reduced the amount of information required from customers but has not addressed the core issue of documentation - arguably the main obstacle posed by CDD to financial inclusion in the country. There is no flexibility for financially excluded groups to present an identity document that may be more accessible to them, as these documents might not fit within the typical CDD framework. Consequently, it can be argued that the absence of clear guidelines for simplified due diligence in the verification process largely overlooks the problem faced by the primary excluded groups in the country, making the framework ineffective.

Finally, the lack of limitations for accounts opened with simplified due diligence exacerbates the financial exclusion issue. A well-defined limitation on an account can lower the risk of misuse and can therefore be offered to certain customers who cannot fully satisfy the standard CDD process. Without such limitations, customers eligible for

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101 The Central Bank of Malaysia is the main authority who governs anti-money laundering and countering financing of terrorism laws in Malaysia. It is responsible for issuing policy documents that help shape the regulations in the country.

102 How this is implied is explained in Paragraph VI(A) “Ascertaining Identity”.

103 See Paragraph VII(A)(1) “Problems in Simplified Due Diligence in Malaysia”.

simplified CDD must be restricted, as granting full access to an account for a customer without sufficient information poses high risk to banks.

In the absence of account limitations, banks have no choice but to limit the offering of simplified due diligence to financially excluded groups. Moreover, limitations on accounts opened with simplified CDD can minimize the potential damage to the bank in case of misuse. Consequently, banks will have more opportunities to address any possible AML/CFT issues and extend their services to financially excluded groups.

2. *Problems in delayed verification and tiered bank accounts opened at agent banks*

This article has examined the initiatives undertaken by agent banks to tackle geographical-related challenges and to promote financial inclusion among rural communities in the country[104]. Through these initiatives, banks can designate existing businesses in rural regions as their agents and provide basic banking services like cash withdrawals, money transfers, and bill payments. Initially, the function of agent banks was restricted to certain transactions only. However, in 2015, the regulations were revised, permitting agent banks to assist customers with opening bank accounts[105]. As per the 2015 Agent Banking Guideline Malaysia, customers may request to open a bank account at an agent bank and then undergo a round of customer due diligence procedures. The CDD undertaken at agent banks involve three steps: 1) collection of identity information from customers; 2) biometric authentication of the information via MyKad through an online real-time system; and 3) forwarding of this information to the relevant

104 See Para III(A) "Rural Communities".
105 Section 8.4 of Agent Banking Guideline Malaysia 2015 (n 31)

main bank[106]. The account is, however, not fully opened at the agent bank; customers will still be required to be present at the main bank branch within three months from account opening to complete the CDD process.

The requirement to be present at the main bank branch within 3 months means the geographical constraint is not effectively eliminated. Despite the significant challenges and costs, customers still need to travel the distance. It is argued that this problem persists due to adopting a time-based tiered system for accounts opened at agent banks instead of the function-based tiered system recommended by FATF[107]. The former means that accounts opened at agent banks must be mandatorily verified within three months from their opening date. The compulsory verification within the specified time limit also means that any consideration of low-risk usage of the account is disregarded, thus contradicting the main purpose of the risk-based approach.

From the FATF standpoint, adopting a tiered system based on functionality is the appropriate risk-based approach to be applied in this situation[108]. The account opened with simplified due diligence is allowed to operate within limited functions and monetary threshold. Further, CDD can be carried out if customers wish to transact beyond the threshold, where it is arguable that they may have more financial capacity to travel to the main bank. This approach unwraps more opportunities for agent banks to complete simplified due diligence procedures at agent outlets without bearing too much risk and potentially eliminates the need to travel altogether for customers with small accounts.

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106 Section 8.9 of Agent Banking Guideline Malaysia 2015 (n 31)

107 FATF, 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations' (n 95).

108 ibid

B. Over-cautious implementation of CDD

Customer due diligence policies in the country have notably influenced financial inclusion through their application by banking institutions. Despite the authorities introducing certain flexibilities to promote financial inclusion, banks seem reluctant to incorporate these changes into their institutional CDD policies. This reluctance often manifests as an over-compliance response, a phenomenon wherein institutions exceed the legal requirements imposed upon them[109].

In the context of AML/CFT, this over-compliance response can be seen when regulators delegate discretion to financial institutions, leading these institutions to limit rather than utilize the discretion granted. For instance, even though regulations have been formulated to allow banks the discretion to accept alternate documents for CDD during account opening, some banks have opted not to exercise this flexibility[110].

Moreover, an overly cautious compliance response is observable in the regulation's failures to implement simplified due diligence[111] for low-risk customers, continuing instead to apply more rigorous measures[112]. Over-reporting of suspicious transactions serves as another example[113]. Institutions often err on the side of caution and report transactions that may not necessarily be suspicious, to circumvent the risk of penalties for non-reporting[114]. Dhillon et al. underscored this issue in Malaysia, commenting that this

109 Louis De Koker and John Symington, 'Conservative Corporate Compliance : Reflections on a Study of Compliance Responses by South African Banks' (2014) 1 Banking and finance: Perspectives on law and regulation 228.

110 An example of this situation is the refusal of Malaysian banks to accept UNHCR card as valid identity document for CDD purposes, despite discretion being given to them to accept the document. See Section III(C) "Refugees".

111 Refer to Section VI(A) "Ascertaining Identity" for a discussion on simplified due diligence in the country.

112 Koker and Symington (n 109)

113 ibid.

114 ibid.

approach might create more false alarms than actual suspicious transactions[115]. Not only does this inflate compliance costs, but it also significantly hampers the efficiency of the suspicious transaction reporting scheme[116].

In Malaysia, the most apparent evidence of over-cautious compliance response is the reluctance of banks to accept the UNHCR card issued to refugees as valid documents for CDD despite the express authorisation by Bank Negara Malaysia to do so. Over-cautious implementation is also evident as banks continue to deny using these identification documents, even though the United Nations has repeatedly stated that the card contains enhanced security features and bears low money laundering risks. It also satisfies all three conditions for acceptable documents for CDD[117]. Consequently, although the government authorities have stated otherwise, the UNHCR card remains unacceptable for CDD purposes, thus negating refugees from their access to banking services.

VII. Potential Solutions

The solutions proposed to improve financial inclusion in Malaysia are derived from an evaluation of the gaps in the country's CDD laws. The remedy for these issues involves easing CDD regulations and adapting these rules to the specific needs of the excluded communities through a risk-based approach. This article substantiates, through detailed analysis, that the problems outlined above can be translated into clear, practical

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115 Guru Dhillon and others, 'The Viability of Enforcement Mechanisms under Money Laundering and Anti-Terrorism Offences in Malaysia: An Overview' (2013) 16 Journal of Money Laundering Control 171.

116 ibid.

117 See Paragraph VI(B) "Verifying Identity" where I explained that the three conditions for acceptable documents for CDD in Malaysia are 1) reliable, 2) backed by a valid registry and 3) issued independent of the customer.

recommendations regarding CDD regulations, which could potentially expand financial inclusion within the country.

The recommendations are highlighted as follows:

- Reducing the documentation requirement for the undocumented and refugees to include only those relevant to AML/CFT regulations.
- Introducing small basic accounts for accounts opened with simplified CDD.
- Widening of the list of acceptable documents for CDD.

A. Reducing the documentation requirement for the undocumented and refugees to include only those relevant to AML/CFT regulations

In accordance with the risk-based approach, it would be advantageous to revisit and potentially relax the current demands on banks concerning customer documentation. If an individual is evaluated and found to be low-risk in terms of potential involvement in money laundering or terrorist financing, the CDD guidelines could be adapted to reflect this. Easements could take the form of reducing the quantity of information required and possibly even dispensing with some traditional documents typically gathered as part of the CDD regime. These changes would align more closely with the goal of achieving both robust AML/CFT measures and promoting financial inclusion.

For example, it is timely to remove the requirement of documents proving the legality of a stay from CDD practices. Neither the Financial Action Task Force (FATF) nor the Basel Committee on Banking Supervision (BCBS) mandated the requirement of these documents in any of their guiding policies[118]. In the context of CDD objectives[119], it is argued that proof of legality of stay does not provide additional value to the intentions behind the implementation of CDD. Even without these documents, a sufficient deterrence and monitoring mechanism can still be conducted within the account, provided other primary information and documents are sufficiently identified and verified. As the objective of banks is mainly to serve and protect the financial system, initiatives should be geared towards reducing opportunities for informal transactions – not policing illegal stays in the country. The former will require banks to accept documentation flexibilities that allow the communities into formal, regulated finance without compromising financial stability.

While we recognise the potential risks associated with reducing CDD requirements—given that less customer information could lead to less comprehensive risk and behavioural profiles for monitoring—it also advocates for considering alternative, possibly more insightful, types of information. For instance, details such as a customer's income source and anticipated product use could be more accessible for customers and paint a clearer picture of their expected transaction profile[120].

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118 The international regulations of customer due diligence merely requires the collection of identity document for CDD purposes and had not recommended the collection of documents verifying legality of stay. See Bank for International Settlements, 'Sound Management of Risks Related to Money Laundering and Financing of Terrorism' (2017) <https://www.bis.org/bcbs/publ/d405.pdf>. and FATF 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations' (n 95).

119 The four objectives of the CDD are; 1) to deter potential customers who intent to launder money via the formal banking system; 2) to obtain information for risk assessment purposes; 3) to feed information into suspicious transaction reports and 4) to provide a basis for tracing movement of money within the financial system. See Josetta S McLaughlin and Deborah Pavelka, 'The Use of Customer Due Diligence to Combat Money Laundering' [2013] Accountancy Business and the Public Interest. and Daniel Mulligan, 'Know Your Customer Regulations And The International Banking System: Towards A General Self-Regulatory Regime' (1999) 2 Fordham International Law Journal.

120 Louis de Koker, 'The Money Laundering Risk Posed by Low-Risk Financial Products in South Africa' (2009) 12 Journal of Money Laundering Control 323.

By incorporating this type of profiling into a simplified due diligence process, the efficacy of transaction monitoring could be enhanced. Any deviation from the established profile could trigger a review of the customer's CDD and, if necessary, lead to the reporting of suspicious transactions. This approach allows for a balance between financial inclusion and the robustness of anti-money laundering and countering financing of terrorism measures.[121].

Moreover, this approach should be complemented by the introduction of an entry-level tiered account system that restricts transactions, balances, and payments to a low threshold[122]. Such limitations significantly diminish the overall risk of money laundering and terrorist financing, rendering the proposed reduced CDD potentially sufficient to fulfil its objectives.[123]. The combination of these strategies could offer a practical solution for enhancing financial inclusion without compromising the efficacy of anti-money laundering and counter-terrorist financing measures.

B. Introduction of entry-level accounts for accounts opened with simplified due diligence

We have explained that geographical issues are one of the challenges rural communities face in opening a bank account. The CDD regulations effectively prohibit agent banks from completing the CDD process, forcing rural communities to travel to the main bank

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121 ibid.

122 See paragraph below VIII(B) "Introduction of entry level accounts" where the introduction of entry-level tiered accounts as a solution to the problems of CDD on financial inclusion is proposed.

123 FATF 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations' (n 95).

branch despite already being identified and verified at the agent bank. Justification for the non-authorisation of agent banks to complete CDD includes high susceptibility to mistakes due to inexperience and less accountability for any legal issues should they arise. As Bank Negara Malaysia does not directly regulate agent banks, the main bank will bear legal responsibility for its activities.

A practical approach that could help mitigate this challenge involves the establishment of 'small accounts'. These accounts would offer a more limited range of banking services, as well as constraints on balance and transaction values when opened at agent banks. In theory, with a smaller scope of services and decreased transaction volumes, these accounts are subject to lower risk[124]. Accordingly, a more streamlined customer due diligence process may adequately fulfil the anti-money laundering and counter-terrorism financing objectives related to these types of accounts[125].

Several countries, such as India and South Africa, introduced this strategy to solve their financial inclusion challenges. In India, banks are authorised to open small savings accounts for low-income customers lacking acceptable forms of identification using simplified CDD norms[126]. The account is subject to strict limitations on the monthly aggregate of withdrawals and transfers and the balance at any point[127]. South Africa has implemented a similar approach, with restricted accounts capped at a maximum balance of £1300. These accounts have a daily transaction limit of R5,000 (approximately £242)

124 FATF ‘International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations’ (n 95).
125 ibid.
126 ibid.
127 ibid.

and a monthly transaction limit of R25,000 (approximately £1211).[128] to set up these accounts, banks only require a copy of the client's identification document. There is no need for additional documentation like proof of address or tax numbers[129].

Drawing from these examples, Malaysia could consider introducing a similar tiered banking system to increase financial inclusion. An 'entry-level' account could be designed to cater specifically to the needs of the low-income population, including individuals from rural regions, and the undocumented, and refugees. Given the assumption that the majority of those facing difficulties in accessing formal financial services belong to lower-income brackets, a daily transaction and ATM withdrawal limit of RM500 (£100) may be practical[130]. Such a limit is unlikely to cause significant hardship for these account holders, given their typical financial activities. In addition, a maximum balance limit of RM5000 could be imposed on these accounts.

In cases where individuals need to engage in transactions exceeding these limits, provisions could be made to allow such transactions to be carried out in a bank branch. This helps maintain the overall risk profile of the account while providing flexibility for account holders in exceptional circumstances.

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128 Alan Gelb, 'Balancing Financial Integrity with Financial Inclusion: The Risk-Based Approach to Know Your Customer' <www.cgdev.org>.

129 ibid.

130 Based on the Statistics Department of Malaysia, the poor communities in Malaysia can be considered as those earning below RM4850 monthly (or approximately £830). See Department of Statistics Malaysia, 'Household Income Estimates and Incidence of Poverty Report, Malaysia 2020' 'https://www.dosm.gov.my/v1/index.php?r=column/cthemeByCat&cat=493&bul_id=VTNHRkdiZkFzenBNd1Y1dmg2UUlrZz09&menu_id=amVoWU54UTl0a21NWmdhMjFMMWcyZz09

To further enhance the utility of these accounts, a mechanism could be implemented to allow customers to apply for a higher daily transaction limit. Approval for such increases could be contingent upon the customer satisfying additional AML/CFT requirements, providing a pathway for account holders to access greater financial services as their circumstances change or improve.

C. *Widening of the list of acceptable documents or alternative modes of verification for CDD purposes*

The mode of identity verification can be widened to include alternative document and non-document methods of authentication. This strategy is beneficial for the undocumented and refugees. They can use a valid, readily available document and a strong non-documentary verification to authenticate their identity. For example, a valid foreign identification card or a passport can be supported by a referral letter issued by a partner non-governmental organisation (NGO) to prove the identity of undocumented migrants or refugees. The "undocumented migrants" in the country does not necessarily mean they do not possess any document at all. Instead, the typical situation is that they possess either unacceptable or insufficient documents to satisfy the CDD process. Similarly, a refugee in Malaysia is usually provided with a UNHCR card, which is currently not acceptable by banks for CDD[131]. Combining the two forms of verification

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131 Refer to Section VII(B) “Over-Cautious Implementation of CDD” where I argued that although the BNM is already allowing the use of UNHCR cards for CDD, banks remain hesitant to accept it, arguably due to the uncertainty of the government’s stand on the status of refugees in the country.

may provide a solid foundation for CDD and adds confidence to banks to accept these individuals as customers.

It is to be mindful that this form of verification may bring about the consequent risk of fraudulent activities and abuse of process. For example, a referral letter can easily be forged. As reported by FATF, in countries where reliance is placed on a letter by the village chief to verify a customer's identity, there are some isolated cases where these village chiefs began demanding money for their verification services[132]. Such integrity issues will defeat the intention behind offering easements and arguably add more financial access challenges. A way to ensure that the process is not abused is to encourage banks to partner with specific NGOs in the country and accept only those letters issued by trusted, partnering NGOs. This way, the process for issuance of referral letters can be monitored to ensure confidence in the value of such letters.

For rural communities, verification via video conferencing for accounts opened at agent banks may provide innovative solutions. Given that agent banks may already have conducted the first level of verification, the CDD process could be further enhanced with a video conference instead of a physical bank branch visit. Several safeguard steps can be taken to acknowledge the risks of identity fraud that may arise from video conferencing. For example, video conferencing must be held at agent banks, with the agent being the witness for the whole procedure. The agent may also authenticate the identity documents, such as MyKad, via smart card readers before proceeding with the process with a video conference with an officer from the main bank branch. The presence

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132 FATF ‘International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations’ (n 95).

of the agent can be sufficient to mitigate any risks of fraudulent activities during the process. The video conference should also be recorded and retained for record purposes.

VIII. Conclusion

This article has critically analysed the interplay between the CDD framework, as stipulated by the Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT) regulations, and its implications for financial inclusion in Malaysia. Specifically, the article undertook an in-depth examination of Malaysia's CDD framework, exploring its potential negative impacts on financial inclusion. It focused on the identification of the financially marginalised communities in Malaysia and endeavoured to understand the root causes of their exclusion. Our argument underscored that rural communities, undocumented migrant workers, and refugees are the three demographics most susceptible to financial exclusion within the country.

While the specific reasons for exclusion may vary, a common factor of exclusion was identified across the three communities: "customer due diligence rules". For rural communities, the CDD imposed difficulties on them to open a bank account as they must physically travel to complete the CDD process. It is also argued that, to the extent that agent banks are not legally allowed to complete the CDD, financial inclusion is not achieved by merely having agent banks operating in rural areas. In relation to undocumented individuals and refugees, the CDD rules in the country imposed challenging documentation requirements that are not achievable by them.

This article analyses specific issues pertaining to the CDD laws in Malaysia, which significantly contribute to financial exclusion. The adopted risk-based approach, it argues, does not effectively target the financially excluded, and the implementation of simplified due diligence measures has proven ineffective in easing the CDD process. These measures do not address verification issues and only cater to select categories of local citizens, leaving out a significant population of non-citizens who comprise a large portion of the financially excluded.Further, the lack of prescriptive rules exacerbates the issue as financial institutions, out of an over-abundance of caution, may insist on implementing standard or enhanced CDD measures even when a customer is eligible for simplified CDD as per the law. This over-compliance approach inadvertently pushes potential customers towards financial exclusion.

The article also scrutinizes the strategy of the risk-based approach implemented in agent banking services, suggesting that the issue isn't with the CDD laws themselves, but rather with the system in which these laws are applied. It identifies the time-based tiered system in Malaysia as problematic, primarily as it does not alleviate distance-related challenges faced by rural communities in accessing banking services.

Moreover, the article highlights the issue of financial institutions' over-compliance with CDD rules due to significant inconsistencies within the CDD laws and surrounding financially excluded communities. The ambiguity and lack of clear guidance in these areas often leads banks to exceed legal requirements as a protective measure, which ironically, results in reinforcing financial exclusion.

This article puts forth three primary recommendations to improve the CDD systems in Malaysia.

Firstly, the identification and documentation requirements for the excluded communities should be restructured and explicitly detailed within a revamped regulatory framework. This change would make it easier for the financially excluded groups to access banking services, fostering financial inclusion without compromising security.

Secondly, innovative strategies such as the introduction of 'entry-level' accounts should be considered. These accounts, opened with simplified due diligence, would cater to those who are currently unable to meet standard CDD requirements. With carefully calibrated transaction and balance limits, these accounts could offer basic financial services while keeping the risk of money laundering and terrorist financing minimal.

Thirdly, the list of acceptable documents for identification verification could be broadened. This approach would make the CDD process more flexible and accessible to individuals who may not possess the traditionally required documents.

In addition to these regulatory and procedural amendments, financial institutions could play a crucial role in enhancing financial inclusion. They could develop educational programs to help their customers understand the significance of CDD and their own role in maintaining the integrity of the financial system. While adhering to Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT) regulations is critical, it is equally important to ensure these regulations don't impede financial inclusion.

By achieving a delicate balance between compliance with regulatory requirements and fostering financial inclusion, financial institutions would be contributing meaningfully to Malaysia's economic growth and societal development. Implementing these recommendations would allow Malaysia to enhance financial inclusion while safeguarding its financial environment from criminal activities.

Word count: 12697 words.

ANNEX 1: CDD REQUIREMENTS FOR BANKS IN MALAYSIA.

BANK	DOCUMENT REQUIREMENT FOR CDD		FINANCIAL INCLUSION STRATEGIES.
	MALAYSIAN CITIZENS	NON-MALAYSIAN CITIZANS	
MAYBANK[133]	Original identity card.	Passport Valid working / student permit Valid visa Letter of confirmation from employer	UNHCR card not accepted for CDD. No other flexibilities stated.
BANK RAKYAT[134]	Identity card	Permanent resident: Passport Employed: Passport Work permit Company verification letter Students: Passport Student pass	UNHCR card not accepted for CDD. No other flexibilities stated.

[133] Maybank, 'Kawanku Savings Account' https://www.maybank2u.com.my/maybank2u/malaysia/en/personal/accounts/savings/kawanku_savings_account.page?.

[134] Bank Rakyat, 'Savings I-Account' https://www.bankrakyat.com.my/c/personal/savings/savings_i_account-24/deposit?fbclid=IwAR2WtpRaASVr4wF08ZAmdQ-5lV4McoWrvU-kq9abyXD-rFw_Y2Q4fFE6fd4

		Matrix Card Higher Education Institute Verification Letter.	
CIMB BANK[135]	Identity card	Passport	UNHCR card not accepted for CDD. No other flexibilities stated.
	A copy of utility bill for verification of address	A copy of utility bill for verification of address	
BANK SIMPANAN NASIONAL[136]	Identity card	Not stated.	Only available for Malaysian citizens and permanent residents. UNHCR card not accepted. No flexibilities stated.
AGROBANK[137]	Identity card	Not stated	Only available for Malaysian citizens

135 CIMB Bank, 'Savings Account i-Plus' https://www.cimb.com.my/en/personal/day-to-day-banking/accounts/savings-account/savings-account-i-plus.html

136 Bank Simpanan Nasional, 'BSN Basic Savings' https://www.bsn.com.my/page/bsn-basic-savings?lang=ms-MY&csrt=3824456818536682661

137 Agrobank, 'Basic Savings Account-I' https://www.agrobank.com.my/product/basic-savings-account-i-agro-bsa-i/

			and permanent residents only. UNHCR card not accepted. No flexibilities stated.
RHB BANK[138]	Original identity card	Passport with minimum validity of 6 months before expiry date	UNHCR card not accepted. No flexibilities stated.
	Proof of ownership of mobile number.	Proof of ownership of mobile number	
		Valid working permit	
		Latest one month payslip or employment letter.	
BANK ISLAM[139]	Identity card	Not stated	UNHCR card not accepted.

[138] RHB Bank, 'Current / Savings Account Opening' https://www.rhbgroup.com/files/personal/current-account/overview/Documents_required_for_account_opening.pdf

[139] Bank Islam 'Basic Savings Account-I' https://www.bankislam.com/personal-banking/deposit-and-investments/deposit-account/basic-savings-account-i/

			No flexibilities stated.