

Terms of Reference: Working Group Safer Corridor Pilot for UK-Somali remittances

Background

Remittances are a major source of private capital for developing countries, with an estimated \$401 billion sent globally in 2012. Remittances to Somalia are estimated at least \$1.2 billion annually¹, accounting for 50% of around Gross National Income. Remittances support the livelihoods of 40% of the population, finance economic development and provide a crucial source of foreign exchange earnings.

The UK-Somali diaspora is one of the oldest and longest-established and is a major source of remittances to Somalia. A preliminary analysis of the market shows that:

1. Remittance channels are based on the 'Xawala' money transfer system trusted by users for its speed, cost², credit facilities and coverage. Money transfer networks in Somalia also facilitate trade finance and the distribution of aid.
2. MSBs are intensive cash handling businesses making them vulnerable to the risk of facilitating illicit financial flows.
3. To simplify, UK-Somali remittances are transacted in three stages;
 - **The first mile:** an agent deposits their takings in the bank account of a UK MSB company and instructs the bank to transfer the money to a third party clearing house;
 - **The second mile:** the clearing house settles the payments using trade-flow mechanisms to reimburse in-country agents;
 - **The last mile:** the local agent receives the payments required to settle balances.
4. At each stage of the remittance transaction, oversight and risk mitigation measures are required by the relevant national regulator. In Somalia, no comprehensive regulatory and oversight framework for payments exists, and governance capacity to build or support the requisite institutions is weak. This prevents the other actors in the value chain from effectively mitigating risks they are responsible for. Remittances, transacted in US dollars, are also subject to provisions under the US Patriot Act.

Supervisory authorities obligate financial institutions to manage anti-money laundering (AML) and counter-financing for terrorism (CFT) risk through the entire transaction. Following financial penalties issued by various authorities, financial institutions have become more risk averse and are exiting client relationships for a range of customer classes including MSBs, particularly those in countries where basic systems for credible financial supervision is lacking. Banks cite that the costs of managing legal and regulatory risks now outweigh commercial returns in the MSB sector.

Although the market is adapting, there are concerns that remittance channels will become less transparent, accessible and affordable. There is an increased risk of payments transferring to informal channels.

Because of the unique role that remittances play in Somalia's development, government, industry, civil society and international partners agreed to support the development and implementation of special measures for ensuring the continued flow of remittances through secure, legitimate and accessible channels under a 'safer corridor' pilot .

¹ Based on recent FNSAU/FAO study. Estimates range from \$0.5 billion to \$1.5 billion

² 5.14% average from UK to Somalia vs. 7.28% average for South Asia and Latin America

Among other things, the pilot will consider and build upon lessons learned from the Pakistan Remittance Initiative (PRI), the safer corridor established for UK-Pakistan remittances in 2008 by Pakistani authorities with support from the National Crime Agency.

Objectives

A specific Working Group will be established in the UK Action Group on Cross Border Remittances to develop and pilot a 'Safer Corridor' for UK-Somali remittances. The Working Group will be led by DFID with support from the National Crime Agency.

The objective of the Safer Corridor pilot will be to ensure the continued flow of UK-Somali remittances through secure, legitimate and accessible formal channels by reducing their exposure to the risk of abuse by illicit finance.

The pilot will integrate ongoing work to:

- Reduce formal financial exclusion;
- Combat criminal money laundering and terrorist financing,
- Develop a global regulatory environment that is effective and proportionate to risks, based on acceptable principles of integrity, transparency and accountability

The Working Group will develop and test a 'safer corridor' pilot project with interventions to improve the security and transparency of remittances at each stage of the UK-Somalia remittance transaction.

Interventions will be coordinated to form a corridor through which remittance transactions subject to credible safeguards can be traced and audited to acceptable standards. Interventions at each stage of the transaction could be applied for developing safer corridors in other regions.

The pilot will also explore opportunities to leverage on existing or developing payment infrastructure both within the corridor and at the regional and global levels.

The pilot will also incorporate longer-term support for building credible and more permanent institutional financial regulatory and oversight capacity in Somalia that are based on rule-of-law principles of integrity, transparency and accountability.

Among other things, the pilot will draw lessons from the Pakistan Remittance Initiative; good practice of industry practitioners, regulators and law enforcement agencies and consultations with external stakeholders.

A detailed set of outputs and outcomes for the safer corridor pilot will be developed by the Working Group. Illustrative interventions include:

- 1. Improved transparency and security of remittances at the last mile**
 - a. Audit processes and safeguards to demonstrate AML/CFT compliance.
 - b. Formalisation and standardisation of customer identification processes.
 - c. Proportionate guidance on AML/CFT compliance in post conflict and fragile states.
 - d. Support for long-term financial regulatory capacity building.
- 2. Improved transparency and security of remittances during clearance**
 - a. Liaise with commercial clearing houses to improve traceability and audit of remittance transactions.
 - b. Review potential alternative clearing house mechanisms.
- 3. Improved understanding and management of risk in the sending market**
 - a. Capacity building for competent authorities/law-enforcement agencies and MSBs to improve understanding and mitigation of AML/CFT risks to

effectively strengthen oversight and compliance with recognized AML and CTF obligations.

- b. Improved customer identification, reporting, recordkeeping procedures and compliance oversight systems.
- c. Consumer financial education to raise awareness of risks and options for improving the security of remittances.

4. Coordination

- a. Multi-stakeholder alliance incorporating industry, government and civil society.
- b. Close liaison with the Action Group on Cross Border Remittances.
- c. International coordination through global networks for financial inclusion, including the G20, financial regulation and law enforcement and financial infrastructure.
- d. Regular consultation with relevant external stakeholders.

5. Monitoring and Evaluation

- a. Baseline for official remittance flows from UK to Somalia.
- b. Lesson learning from other relevant initiatives (e.g, the Pakistan Remittance Initiative).
- c. Undertake market and political-economy assessments in Somaliland, Puntland and South Central.
- d. Evaluation framework to assess the efficacy of the pilot.

Structure and Membership

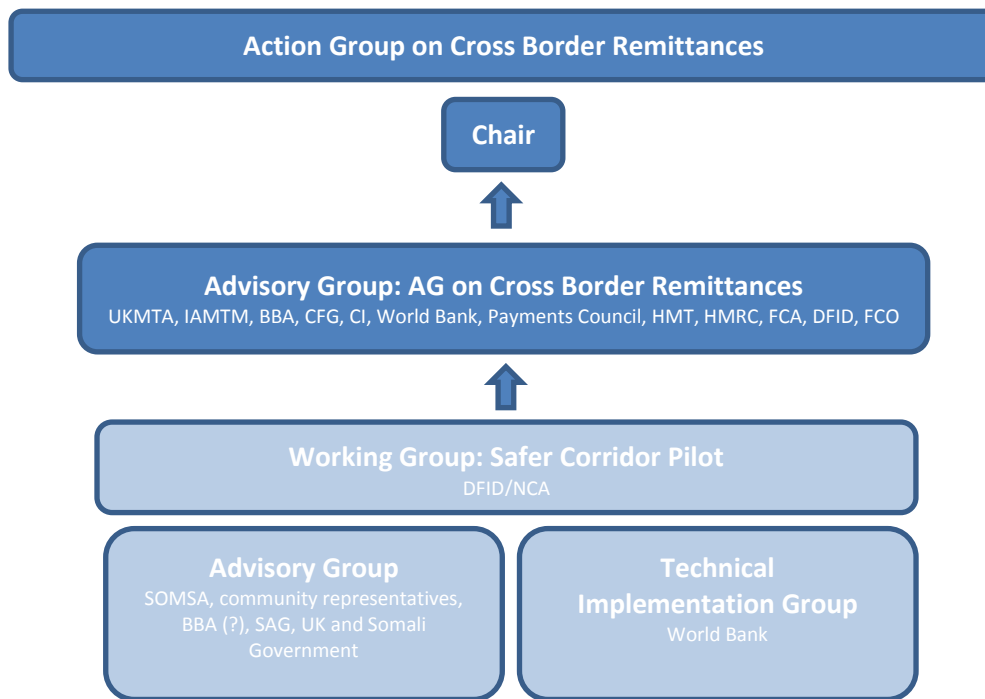
The Safer Corridor Working Group will be led by DFID with support from the National Crime Agency (NCA).

The Working Group will comprise of an advisory group and a technical implementation team.

Membership of the advisory group will be drawn from representatives of UK-Somali MSBs, the UK-Somali community, banks, regulators, NGOs, international partners and the UK and Somali governments. Additional experts may be consulted where their input would be helpful. Participation will be non-remunerated

The technical implementation team comprised of technical partners and experts will design, implement and test the safer corridor pilot with guidance from the Advisory Group. The World Bank will lead the technical implementation team.

The Working Group will report on its progress to the Chair of the Action Group on Cross Border Remittances against agreed milestones and performance indicators.



Timescale

The timescale for developing and testing the pilot is 12 months as set out in the Written Ministerial Statement 10 October. Support for financial sector regulatory capacity building will continue beyond the pilot.

Alignment

Identified interventions under the Safer Corridor pilot will be aligned with work under the 'New Deal' for Somalia and other initiatives undertaken by partner organisations to avoid duplication of effort and ensure maximum efficiency in the allocation of resources.