

CONCEPT NOTE

PROJECT TO SUPPORT REMITTANCE FLOWS TO SOMALIA (SRFS)

Executive Summary

Objective: The proposed project aims to tackle key issues affecting remittance flows to Somalia, with a particular focus on the UK-Somalia remittance corridor, until a sounder financial system is in place in Somalia, and to accelerate and support the development of that financial system. More specifically, this project is intended as an interim set of activities to support the supervisory role of the Central Bank of Somalia. This project will also support the Somali Federal Government’s plan on the formalization of the Somali financial sector.

Summary: The World Bank (WB), initially at the request of and in close coordination and collaboration with the UK government¹ and also in full coordination also with the Somali authorities, is designing solutions to support the continued flow of remittances to Somalia, with a particular focus on the UK-Somalia remittance corridor. Subject of discussions with the UK authorities since July 2013, this project was initiated in February 2014 as a result of severance in the UK of direct access to banking services by money transfer operators (MTOs) serving the UK-Somalia remittances corridor.

The project is not meant to provide a solution for implementation in other cases or for other corridors, but will provide a proposed set of activities for implementation, in light of the unique circumstances in Somalia – both with regards to the importance of remittances and the risk of abuse for illicit purposes (specifically terrorism financing). During the design of the project, engagement with the Somali authorities has been increasing, to ensure their ownership of the proposal, the set-up of a sound legal and regulatory basis for its roll-out in Somalia, and a sound articulation with their vision for the longer term shaping of the Somali financial sector.

While the intended entry point of this project is through the Federal Government of Somalia, depending on progress made, it will be necessary to communicate with other regions of Somalia in order to expand the scope and reach of the activities to be covered under this project.

This project will be referred to as the Project to Support Remittance Flows to Somalia (SRFS, or the “project”), and will contain core, temporary, and contingency elements. The core and temporary elements should be implemented regardless of a significant remittance flow disruption, and the contingency elements should be implemented *only* if there is a significant remittance flow disruption.

This concept note will explain the current state of play for the UK-Somalia remittances corridor, the drivers and challenges identified which are causing the fragility in the market, and the possible solutions to address those issues – including what the WB project itself will entail, and its articulation with needed action by other stakeholders (primarily Somalia and the UK). It will also analyze the rationale for the WB

¹ The primary agencies in the UK government involved in this project include the UK Department for International Development (DfID) and Her Majesty’s Treasury (HMT), and to a lesser extent HM Revenue and Customs (HMRC) and the UK National Crime Agency (NCA). The project is overseen by the UK Government’s Action Group on Cross-Border Remittances.

to be involved. The concept note will explore risks and risk management measures for the World Bank as an implementing partner and in the context of the project.

This project is being developed in close coordination and as a complement to the longer-term WB project with Somalia, Somali Core Economic Institutions and Opportunities Program (SCORE) being led by co-TTLs Ben Musuku (Senior Financial Sector Specialist, GFMDR) and Suhail Kassim (Senior Private Sector Development Specialist, GTCDR).

Timeframe: 1 June 2015 – 30 November 2017², with option to extend to 30 November 2019

Project budget: 2,255,000 USD (estimate), with option to extend will total 3,705,000 USD. This project will be funded by DfID, partly through funding paid into HiFi (the payment systems trust fund) and partly through funding paid into the Somalia Multi Partner Fund (SMPF) (with a separate infusion specifically for this project).

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Peer Reviewers: Charlotte Coles (UK DfID), Scott Rembrandt (US Treasury), Christian Eigen-Zucchi (Senior Economist, DECPG), and Frank Fariello (Lead Counsel, LEGOP).

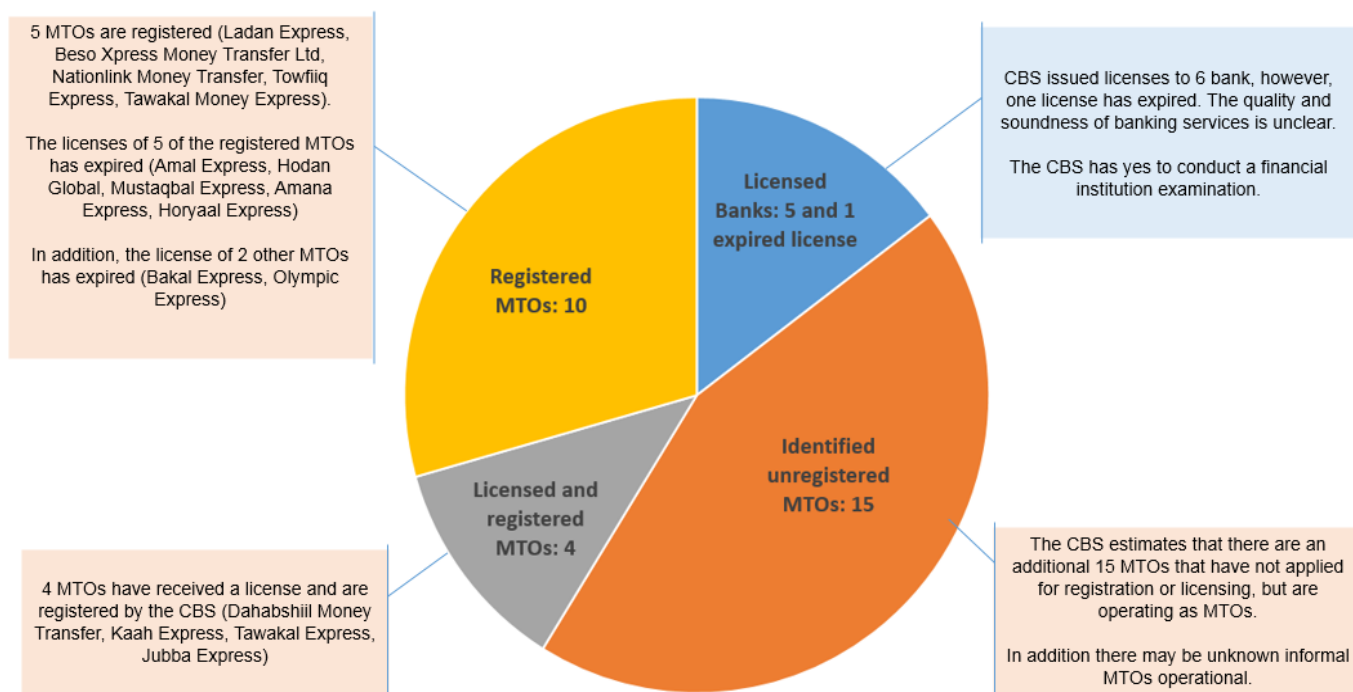
² This proposed timeframe includes drafting, procurement, and 24 months of implementation, with option to extend an additional 24 months of implementation. See Critical Path for more details.

I. UK-SOMALIA REMITTANCES CONTEXT

1. The regulated financial sector of Somalia is limited in size, simple in structure, and is extremely isolated from the global financial infrastructure. Between 1991 and 2009, Somalia had no central monetary authority and hence no regulated financial sector. In 2011 the government passed the Central Bank of Somalia Act, which re-instated the Central Bank of Somalia (CBS). In 2012 the government passed a Financial Institutions Act (FIA 2012) which created a national framework for financial institutions to operate in Somalia, supervised by the CBS. The Somali Parliament has not yet passed a draft AML/CFT law, though Somalia's Council of Ministers has approved it. During the period prior to 2012 and in the absence of a domestic banking system linked to the global financial infrastructure, an extensive network of money transfer operators (MTOs) developed in order to facilitate international remittance flows, domestic financial transactions, and trade with Somalia. That network of MTOs still exists, and is in the process of becoming regulated and supervised under the FIA 2012. Registration regulations and licensing regulations for MTOs were also issued by the CBS in 2015. A chart of the identified financial institutions operating in Somalia recognized by the CBS, as of March 2015, is included below (Figure 1).³

Figure 1: Financial institutions operating in Somalia, March 2015

³ At the moment CBS is focusing on registration. Under the regulations, licensing demands a higher standard to be met by the applicant and more information disclosures to test fitness and propriety of owners, partners, directors and officers. Others include mandatory requirements to have an in-house AML program with training and an AML officer. It also requires for validation and verification of the information and statements made by applicants. Under these regulations, CBS is also required to review risk and risk management elements and will modulate the level of sophistication needed on an institution-by-institution basis commensurate with the level of risk. The review process under the registration regulation is limited to CBS officials checking content of information, such as, in support of ascertaining completeness of applications.



2. International remittances to Somalia are estimated at USD 1.2 billion annually, accounting for around 50 percent of gross national income (GNI). Remittances represent a critical lifeline to Somalia, supporting the livelihoods of 40 percent of the population (approximately 3.4 million people),⁴ financing economic development, and providing a crucial source of foreign exchange earnings.⁵ Any material reduction in the remittances flows to Somalia could have significant development and humanitarian impacts on the population. Remittances originate mainly from the US, the UK, Canada, other Western European (particularly Scandinavian) countries, the Middle East (particularly UAE), and some neighboring countries (such as Kenya).

3. A unique characteristic of the Somali economy is its isolation from the global financial infrastructure. While the CBS maintained a number of correspondent accounts in the past, those accounts are no longer active. The CBS currently maintains an active client account with a Turkish state-owned bank (Ziraat Bankasi). The CBS has provisionally licensed 6 domestic banks⁶ to operate in Somalia as at March 2015, but it is unclear if these banks have so far been able to establish cross border correspondent

⁴ No official estimates are available for remittances flows to Somalia. Data quoted here are from academic researchers, and mainly Laura Hammond, SOAS.

⁵ The World Bank estimate that \$550 billion international remittances were transferred in 2013 globally, of which \$414 billion went to developing countries.

⁶ The 6 provisionally licensed banks include the following: (1) Dahabshil Bank International, (2) Salama Somali Bank, (3) Trust African Bank, (4) Premier Bank, (5) International Bank of Somalia, and (6) Amal Bank. The license for Amal Bank has, however, expired.

accounts⁷. MTOs are the primary financial institutions operating in Somalia. MTOs do not maintain correspondent banking relationships – they operate via recirculation of cash in the Somali economy, settled with trade transaction clearing and settling with their corresponding MTOs operating in a third country, primarily the UAE (see Figure 2, below).

4. According to the United Nations Sanctions Committee Monitoring Group on Somalia, Harakaat al-Shabaab al-Mujaahidiin (al-Shabaab) remains the principal threat to peace and security in Somalia and throughout the Horn of Africa. The al-Shabaab threat continues to reverberate throughout southern and central Somalia, and neighboring countries, and has expanded its operational reach beyond the capital, Mogadishu. Al-Shabaab has been designated as a terrorist organization by Australia, Canada, the European Union, New Zealand, Norway, Singapore, the United States and the United Arab Emirates⁸. Having an active designated terrorist organization in Somalia has a direct effect on decisions taken by international banks to restrict or cut off financial activity given the associated terrorism financing sanctions risk. This sanctions risk is compounded by a lack of reliable identification documentation in Somalia for financial institutions to ensure they know their customer and make certain they are not dealing with a designated terrorist, which are only exacerbated by the lack of financial institution supervision in Somalia. The lack of reliable identification documentation will be explored further below. Given recent global enforcement actions against international banks, limited profit potential, new capital adequacy obligations under Basel III, specific concerns related to specific jurisdictions and financial institutions' AML/CFT controls, cross-border information-sharing barriers, and increased management accountability, these financial institutions have in some cases reduced their level of risk appetite towards customers and transactions presenting more serious terrorism financing and sanctions risks. While establishing clear causality is difficult, it is worth noting that Somali MTO account closures challenges have been more acute in Australia, the UK and the US, though remittances have continued to Somalia.

5. In order to understand the complexities of the UK-Somalia remittance corridor, one must understand the movement of both information and money – which are distinct. The following scheme is the most prevalent for UK generated remittances, described here and illustrated in Figure 2:

- Upon receipt of the funds (which previously could have been via debit cards but now must be conducted in cash due to the absence of MTO bank accounts) and instruction from its customer, a remittance agent initiates a money transfer transaction. A message is sent through the MTO's clearinghouse, typically in Dubai, to an agent in Somalia, where the transaction amount is paid out to the receiver in Somalia; most MTOs claim that the sum is available to the receiver within minutes.
- At the end of the day or the following day, the MTO aggregates the amounts collected by its agents, deposits the funds in a UK bank account, and transfers the aggregated amount to a bank account held by the same MTO in a third country, usually the UAE (Dubai) – because transactions cannot be cleared and settled in Somalia due to the lack of a financial system that is connected to the global financial sector. This transfer is sent using a UK bank through an MTO

⁷ The CBS, as well as some of the provisionally licensed banks have SWIFT codes, which allow the circulation of information (not funds). CBS has used SWIFT for circulation of information on receipts of funds and is yet to do so on payouts. It is unknown if the provisionally licensed banks use SWIFT to circulate information on international funds transfers. This is different from a correspondent banking relationship, which would allow the circulation of *funds*.

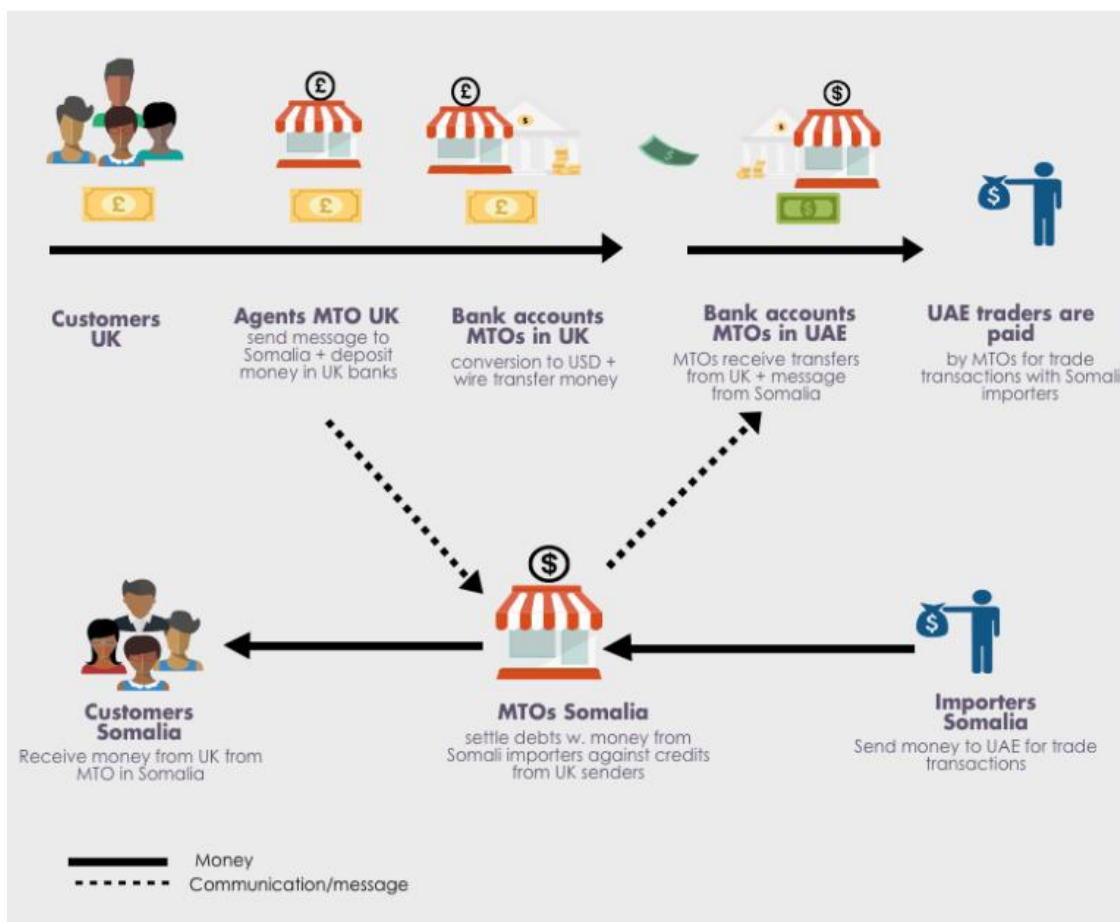
⁸ While these jurisdictions designated al-Shabaab at various times, the earliest designation took place during March 2008.

aggregator (which still has a bank account with a commercial bank in the UK; there are no UK-Somali MTOs who directly maintain a commercial bank account in the UK).

- The accounts held by MTOs in UAE are generally USD-denominated accounts, so in the case of the UK, currency exchange also occurs at the MTO aggregator or UK bank level.
- The amounts received in the UAE are then used by the MTOs in the UAE to pay recipients in the UAE on behalf of senders in Somalia. This is where the UAE becomes the location of a de facto “settlement mechanism” for remittances and trade flows involving Somalia⁹. This is not always a closed loop and the net position may need to be managed. Sometimes, in such situations, MTOs will physically transfer cash to manage the surplus/shortage.
- Generally, payees for these transactions are exporters based in UAE and payers are Somali companies importing goods to Somalia. MTOs can be affiliated and controlled by trading firms but it is not clear what portion of MTOs are run by trading firms. In this way, the MTO in Somalia receives back the liquidity disbursed to deliver the remittances and settles the foreign payments of the importers using the flows received from the UK in the UAE. This system bypasses at the same time the impossibility for the MTO to send any money into Somalia and the impossibility for the Somali companies to send funds abroad to purchase goods (given that there are no banks licensed operating in Somalia with correspondent banking relationships).

⁹ Please note this description is a bit simplistic, as funds from other sending countries to Somalia are also aggregated in Dubai, and these are likely mingled at this stage.

Figure 2: Understanding the remittance flows through the UK-Somalia corridor



6. The scheme described above is the one that was employed by most users of this corridor; noting that some variation of this network of money transmitters and traders between Somalia and the Middle East has been in existence since the 1960s. It is a result of the private sector creatively meeting the needs of its customers in light of an unstable operating environment in Somalia. It is built on trust and relationships and is deeply embedded in the economic and social system of Somalia. While there is a clear need for Somalia to develop banking institutions with international connections, the current scheme should not be dismissed as overly complex and opaque as the current operators seek possible solutions to their money transfer needs.

7. As the UK commercial banks have taken decisions to close the bank accounts of the individual operators, there have been several changes in the way that the MTOs operate. First, instead of having the option of taking debit cards in their offices or over the internet, customers must withdraw cash and take it to the MTO offices in person. The MTOs then, instead of depositing cash in the local branch of their bank, have to physically transport it to an aggregator. The loss of access to bank accounts by certain MTOs has led to the emergence of two “wholesale MTOs” or “aggregators” – namely Choice and Moneycorp. Choice aggregates on behalf of 15 members of SOMSA, and Dahabshiil maintains a relationship with Moneycorp. Currently, both aggregators have maintained access to commercial bank accounts. While this aggregator construct has been able to sustain the market thus far, there is serious

concern from both the individual MTOs and the aggregators that it is fragile situation and could change very quickly. Further, the arrangements are less transparent than the previous construct whereby it was easier to see the movements from the sender's own accounts/cards. If the aggregators cease to have bank accounts, they would likely resort to couriating cash. Some of the remitters appear to already be moving some funds in cash.

8. The current Somali MTO market in the UK consists of 16 operators, all of whom are members of the Somali Money Services Association (SOMSA). One operator (Dahabshiil) controls at least half of the market volume, while the other 15 operators control the remainder. According to HMRC, the UK AML supervisor for MTOs, the capacity amongst these operators to effectively implement AML/CFT controls varies.

9. Some have put the closure of Somali MTOs' bank accounts in the UK in the context of a broader trend in the global financial system of "de-risking" – commercial banks terminating or restricting business relationships with clients (primarily MTOs, civil society organizations, politically exposed persons, etc.) that they consider to present an unacceptable or unmanageable level of risk to the institution. This issue has gained attention recently in many fora – the G20, the Financial Stability Board (FSB), the Financial Action Task Force (FATF), among others – as policymakers worldwide are seeking to understand the phenomenon and its intensity, and determine how best to address it in the longer term. However, the situation of Somalia is unique and is receiving close attention in the immediate term because of the importance of remittances to Somalia and because of the political constituency that the Somali diaspora represents in the UK and the US (the two greatest remittance sending countries to Somalia).

10. Several regulators have issued statements confirming that banks should take a risk based approach and not de-bank whole classes of customers. A statement to this effect was issued on 27 April 2015 by the UK's Financial Conduct Authority (FCA). Several agencies in the United States have also issued statements: the US Financial Crimes Enforcement Network (FinCEN) issued a statement; on 10 November 2014; the Office of the Comptroller of the Currency issued a statement on 19 November 2014 and the Federal Deposit Insurance Corporation issued a statement on January 28, 2015. Australia also issued a statement on XX, XX, as has New Zealand on XX, XX.

II. CORRIDOR: DRIVERS AND CHALLENGES

11. Commercial banks operating in the UK report having taken the decision to close Somali MTO bank accounts after consideration of many factors. In order to fully understand the challenges with the corridor, one must explore the drivers, as presented by the commercial banks, of the account closure. At the same time, UK banks continue to provide indirect wire transfers to the remitters. Given stakeholder consultation to date, the following drivers have been identified by UK banks of closing the MTO accounts, listed here by jurisdiction:

- UK-related drivers
 - a) A declared stronger risk aversion (criminal, regulatory, and reputational)¹⁰ of UK banks' senior management to this specific remittance corridor and remittance customers in general,

¹⁰ Some of this stated risk aversion stems from the fact that the transactions between the UK and the UAE is conducted is cleared through U.S., thereby creating a nexus with US jurisdiction and the potential ability of US regulators or law enforcement to take enforcement action against them for violations of U.S. law..

- further increased after the recent AML/CFT non-compliance enforcement actions in the US and EU. This risk aversion is compounded by the existence of targeted financial sanctions, which are rules based obligations, and the stated concerns by senior management in these institutions regarding the potential legal and reputational implications of fund transfers by their banks to al-Shabaab via remittance channels, despite the lack of enforcement obligations against banks by U.S. or U.K. authorities related to the transmission of funds by remitters to al-Shabaab;
- b) Banks' obligation to comply with their own anti-money laundering/countering the financing of terrorism (AML/CFT) framework in the UK;
 - c) A stated lack of clarity by UK banks as to what degree they need to conduct due diligence on the MTO's customer base (given their and their US counterparts' interpretation of US regulations, and their correspondent relationships to US banks), although the FinCEN 10 November 2014 statement on banking expectations for money services businesses clearly stated that banks are not expected to know their customers' customers;
 - d) Insufficient, unclear, or inconsistent ML/TF risk differentiation information from authorities in the UK;
 - e) Low financial benefit to the provision of such banking services, particularly with smaller MTOs, in part because of compliance costs.
- UAE-related drivers
 - a) Lack of understanding of the transaction/compensation chain after the money leaves the UK for clearing and settlement in the UAE;
 - b) Concerns about UAE's reputation more widely in terms of financial crime activity, particularly as it relates to political will and capacity.
 - Somalia-related drivers
 - a) Concern about terrorism financing and other financial crimes;
 - b) Lack of a credible AML/CFT framework in Somalia (i.e. no assurance there are rules in place, or supervision and enforcement of those rules, in the MTO sector);
 - c) Difficulty to identify the end recipient of the transaction given the lack of clear due diligence requirements and credible identification documents in Somalia (and associated exposure to TF sanctions risk).

12. While certain drivers are a result of the environment (senior management risk aversion), other drivers are directly linked to challenges along the corridor. Those challenges are described in greater detail below, by country.

13. UK-based challenges:

- Potential shortfalls in capacity of some MTOs in the UK: This is linked to the driver of a bank's obligation to comply with its own AML/CFT framework. The banks do not have confidence in the capacity of the MTO sector in the UK to comply with their own obligations, thus exposing the bank to risk. There have also been concerns expressed of inadequate supervision of MTOs generally in the U.K. HMRC has indicated that the capacity to conduct effective AML/CFT due diligence within the UK MTO sector varies, with some players having concerning deficiencies in their internal controls. HMRC is working with those MTOs to address the deficiencies that have been identified. HMRC, as the tax authority, has legal restrictions on information that can be shared with others, so cannot provide information to the banks which the banks could use to differentiate between MTOs.
- Lack of risk information by regulators/supervisors in the UK: The regulation and supervision of MTOs in the UK has increased and strengthened over the past few years. In addition, NCA has provided more detailed guidance on risks associated with MTOs in Somalia. Consultations with

the private sector in the UK highlighted a disconnect between the banks' perception of the TF risks and the assessment of the TF risks by the public authorities. For that reason, more information on risk differentiation would be helpful in order to close that gap.

- Lack of understanding by UK banks regarding US regulatory expectations: There is a perception in some of the UK banking sector that the US regulatory expectation is that a bank is expected to know their customer's customer. This perception is not based on any specific US regulation, but a reinterpretation by some UK banks of regulatory actions taken by US regulators. The FinCEN statement of 10 November 2014 which clearly states there is no such requirement has been recirculated to the UK banks.
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14. UAE-based challenges:

- Lack of understanding of the clearing and settlement scheme for Somali remittances, notably regarding customer due diligence: The clearing and settlement in the UAE of remittances to Somalia involve third party country market players (most often traders) as remittances are used to support trade transactions between customers in the UAE and Somalia. This settlement is conducted by the MTO, and is at the moment not visible to the banks processing the aggregated transfers¹¹. The information about all the parties and amounts involved is known to the MTO, but at the bank level it appears to be an aggregated transaction between MTOs. In the UAE, the MTOs are subject to AML/CFT requirements, and therefore have to conduct due diligence on their clients (including the traders), and the rationale for these transactions. In Somalia, MTO agents also conduct some degree of due diligence on the market players depositing cash with them. While this system helps resolve the issue of Somalia's lack of correspondent banking relationships, it is described by the UK commercial banks as creating an issue as they lose visibility to the transaction level information. At the same time, it is worth noting that MTOs, through their integrated IT systems, have information on the whole, end-to-end transaction and the parties to it. There was also some concern that MTOs in the UAE were carrying out "trade finance" or lending transactions which might present a greater AML/CTF risk. They only charge a remittance type fee and do not provide credit in the UAE. The settlement in the UAE may occur after the recipient of the remittance has been paid in Somalia as the MTOs want to provide a swift service to their sending clients by paying the recipient quickly.

15. Somalia-based challenges:

- Lack of regulation and supervision of MTOs: While the Central Bank has issued regulations for both registration and licensing in the MTO sector, there are no operational regulations (in particular with regards to due diligence on clients and record keeping) nor on-site/off-site supervision of the operators. To date, four MTOs have been licensed and nine MTOs have been registered by the CBS (see Figure 1). This lack of regulation and supervision is a significant deficiency that causes the sending country banks to be weary of working with this corridor.
- Lack of reliable identification of the recipient in Somalia: As mentioned above, there are no operational regulations for the MTOs in Somalia, and it is unclear how an MTO conducts due diligence to identify their customers. In addition and compounding this problem, the credibility of identification documentation in Somalia is in question. Customer identification is a serious

¹¹ However, it is possible for the UK banks to request this information directly from the UAE-based MTOs

concern for foreign financial institutions, especially given the TF sanctions risk that exists in Somalia.

III. POSSIBLE SOLUTIONS: POLICY AND TECHNICAL RESPONSES

16. There are a number of possible solutions to address the situation at hand (in whole or in part) and impending concerns that the flow of remittances will continue to be significantly disrupted or frozen. This section will differentiate between those possibilities as follows: a) transferring risk from the private to the public sector; b) a private sector solution for the MTOs; c) considering alternative methods to alter the current market construct; and d) addressing the challenges with the current UK-Somalia remittance corridor construct. Options a, b, and c would all be difficult to implement and could create significant negative externalities. As such, option d or addressing the challenges with the current UK-Somalia remittance corridor construct is the only viable option.

POSSIBLE SOLUTIONS

a) Transferring risk from the private to the public sector

17. The current situation has arisen primarily due to unwillingness of the private sector to manage directly the level of risk of the UK-Somalia remittance corridor, notably in light of the low commercial profit. A different approach to consider would be to encourage public sector takeover of the aforementioned risks, moving from a market construct where the onus is on the commercial banks to carry out due diligence, to one where the public sector takes on and manages the regulatory risks. Such options would be relevant in the UK, and could also envision a more active role for the CBS in particular and include options to bypass the UAE.

18. It has been proposed in the media that the multilateral development banks become a global clearing center for migrants' remittances. However in doing so, these banks would take on a role that would typically pertain to the private sector and be out of the institutional purpose of these banks. Following a basic principle of subsidiarity, these banks should not intervene where private sectors players and market solutions still remain available to serve the public needs. Also, these banks would have to comply with the same set of laws, regulations, and international standards as any other bank or private sector player. Similarly, these banks would face the same risks as any other entity playing such a role, including operational, legal, and reputational risks. Therefore, there is no competitive advantage to these banks in becoming a remittance center. Moreover, these banks may not currently have the expertise to play such a role. Expertise can certainly be developed, but that would require time and significant resources. Also, it may not be assumed that these banks would be in the position to rapidly develop an expertise superior to that of commercial banks that have operated in the sector for decades. Additionally, these banks would still need to leverage the banking sector network for the management of the cash flows at domestic level, in order to serve the MTOs agents in their role of collector and disbursers of the remittances. In other words, this solution would only address the less challenging part of the problem, which is the transfer of value from one country to another; the issue of handling the transactions domestically on the sending and receiving side (where the highest concerns seem to be) would remain unresolved. Finally, becoming a "remittance center" would mean playing an active role in the global remittances market. For the WB specifically, this would naturally jeopardize the role of impartial observer and advocate that the WB has been playing on this matter thus far.

19. CBS maintains a client account (not a correspondent banking relationship) with a Turkish bank - Ziraat Bankasi. In addition, the Central Bank of Somaliland has indicated they have correspondent banking relationships with banks in Kenya and Djibouti. While these pre-existing active relationships

could provide opportunities through which to establish alternative routes for ODA by development institutions and possibly remittances by Somali households their practical value is limited because these banks do not have branches in the UK.

20. The Bank of England and CBS could also agree to provide bank accounts for MTOs in the UK and Somalia respectively; allowing for monies to be wired from one central bank to the other. However at this stage, there is no relationship between the Bank of England and the CBS. Also, the ability and capacity of the Bank of England to conduct the needed AML/CFT due diligence is not commensurate with the risk, and the Bank of England is not willing/able to provide bank accounts to MTOs in the UK. On the Somali side, CBS (with WB support) is just beginning to strengthen its banking operations and accounting functions by implementing a technology based solution for core banking and accounting. Only when this process is completed can CBS have a realistic expectation of success exploring options to establish active correspondent banking relationships in other third party countries or even foreign commercial banks. Given that none of these relationships have been established, these options would be part of the longer-term goal to develop the CBS, and achieve integration of the Somali financial sector with the global financial infrastructure.

21. Another suggestion would be to explore how development institutions could send money to Somalia. For example, for the disbursement of grant funds from the World Bank, funds are transferred through commercial banks in the US to a correspondent bank in Turkey to a Designated Account in USD that was opened with the CBS for this purpose. Withdrawals from the Designated Account for projects take place under strict disbursement arrangements. It is foreseen that in future, the funds will be disbursed to third parties (e.g. vendors and contractors) through verified MTOs that have obtained licenses and commercial banks once they are licensed.

b) Establishment of a Somali MTO-owned Bank in the UK

22. A far more complex and longer-term alternative could be to set up a bank in the UK (which would need to meet the appropriate capital requirements), which will be owned and controlled by MTOs, who would agree to bank MTOs and would establish its own correspondent banking relationship. Preliminary research by DfID's contractor in this area suggests the costs could be prohibitive (minimum £30m for technology and regulatory compliance set up) and the bank would need to reach agreement to join the UK payment and settlement systems or contract with another bank to provide access - this might in itself be difficult (despite the rules on non-discriminatory access).

c) Considering alternative methods of intervention to alter the current market construct

23. Aside from options for public sector takeover of risk and acknowledging the concerns that exist with the current capacity of the CBS, alternative methods of intervention in the UK-Somalia corridor have been suggested that would result in the alteration of the current market construct.

24. There have been stakeholder consultations with the private sector to understand what actions they have taken as a result of the closure of banking relationships. These consultations with the private sector took place in the UK (MTOs, banks) and in Kenya and UAE (MTOs) An MTO that continues to operate between the UK and Somalia, indicated that in light of having lost their bank accounts in the UK, they had arranged for the physical transportation of currency directly to the UAE. Arranging for or subsidizing the cost of the physical transportation of currency to the UAE or directly to Somalia is a creative alternative but it would only serve as a short term solution and not lend to the long term objective of building capacity and developing the financial sector in Somalia.

25. Another option that has been recommended is to scale up the use of mobile payment services within Somalia. This could be a way in which to address concerns along the third mile of the UK-Somalia corridor and possibly achieve greater transparency on the recipient side of the remittance flows. In addition, mobile money is highly convenient as it is generally available universally in the dollarized Somali economy, unlike currency (banknotes) which can be frequently in short supply, especially in rural areas thereby making mobile money transactions low cost. Mobile money transfers are not taxed in Somalia.

26. A significant portion of Somalia (estimated to be 90%) has access to mobile services, and there are currently 5 telecom providers offering value transfers within their respective networks. At this stage, there is no legal framework for the regulation of these providers, with only temporary licenses issued to date. The mobile payment services are being provided directly (with no backing by any financial institution, leading to very high risk for customers) and there are no existing financial sector regulations. These would need to be adopted for this to be a viable solution. Furthermore the provision of SIM cards is currently unregulated and not subject to any standardized customer identification measures, which presents challenges for customer identification. There are on-going discussions between the providers to enable international inter-connectivity of voice and data services. The main issue is however that mobile money only presents a solution at the receiving end in Somalia. It would still be necessary to have a bank transfer funds from the UK to the UAE or the UK to Somalia.

27. Should this proposal to use mobile payment services be further developed, it would be necessary to support the development of the market, and further understand the various risks posed in this particular operating environment. Among other significant tasks related to this idea, it would also be necessary to consider how to develop an identification infrastructure at the time of provision of the SIM cards, in order to register the customers who receive the incoming transfers. This feasibility of this work is currently being explored under the SCORE project.

28. Many of these solutions attempt to create alternative remittance corridors or to bypass the UAE in the UK-Somalia corridor. At this stage, insufficient analysis has been carried out for the economic costs and political implications of these solutions. However, the limited information available would indicate that any attempts to bypass the UAE would have very serious implications for longstanding trading relationships between Somali importers and international traders (including in the UAE).

PROPOSED SOLUTION

d) Addressing the challenges with the current UK-Somalia remittance corridor construct

29. The fourth way to approach this is to consider the challenges as they have been identified in the current UK–Somalia remittance corridor, and explore the various solutions available in the different jurisdictions in the transaction chain. The possible solutions are presented below in the order of the chain, based on the location where the deficiency occurs. The solutions discussed here represent the project as a whole, which will contain core, temporary, and contingency elements. The core and temporary elements should be implemented regardless of a significant remittance flow disruption, and the contingency elements should be implemented *only* if there is a significant remittance flow disruption. Those elements will be clearly differentiated below.

Detail on UK-based solutions:

30. A great deal of work has already been completed by UK authorities in the past year to address the deficiencies in the UK. HMRC has produced new compliance guidance for remittance companies and

the Joint Money Laundering Steering Group produced new guidance for banks that provide services to remittance companies. NCA has worked with HMRC and the Joint Money Laundering Steering Group (JMLSG) to develop new risk guidance. Also, detailed consultations with banks and remittance companies were held to better understand what risks they face and identify how these risks can be better managed. NCA has also shared its assessment of threats to the MSB sector with the steering group and banks to allow for better management of the threats. During the course of 2015, the Action Group on Cross Border Remittances plans to continue monitoring developments in the market and to engage with banks, supervisors and MSB trade associations to report on changes in the risk picture and provide information to help the sector and their service providers manage the risks of being exploited by criminal groups.

- Increasing AML/CFT supervision: To address some of the concerns raised by the UK banks, the UK authorities can continue to strengthen the AML/CFT compliance of MTOs in the UK, as these would contribute to both reducing the regulatory risk, and strengthening the management of terrorism financing risks. Supervision of MTOs by HMRC can continue to be bolstered through supporting the MTO sector in increasing the compliance with AML/CFT regulations. This solution would be part of the core elements, and would be coordinated by HMG.
- Raising industry standards: The UK-based Somali MTOs have indicated they are considering creating a minimum self-regulatory standard for MTOs with the help of a financial services firm. This standard would go beyond the statutory requirements and include most of the best practices and would apply in both the UK and Dubai. Officials at the UAE Central Bank have expressed some interest in the idea. The banks indicated such a standard would help especially if as indicated by the MTOs they would subject themselves to a third party audit and make that audit available to the banks. HMRC has indicated it could help in providing technical input to such a standard.
- Sharing information on risks with Banks/MTOs: Banks would also benefit from detailed information on the terrorist financing risks associated with Somalia and money remitters operating there from UK authorities so that they can adopt a tailored risk-based approach and avoid de-risking MTOs across the board. This would allow banks to better allocate their compliance resources based on a deepened understanding of the risk profile, thereby also improving the financial benefits of providing banking services. Such information could be provided on a continued basis, based on analysis by HMRC, the NCA, NTFIU (National Terrorist Finance Investigation Unit) and other relevant departments/agencies. HMRC, however, cannot however give specific guidance on individual MTO compliance. FCO (Foreign & Commonwealth Office) and DfID have indicated could provide more information around the risks in Somalia and progress made in fighting al-Shabab the different regions of Somalia. As above, this measure would contribute to a longer-term development and serves as a general recommendation. This solution would be part of the core elements, and would be coordinated by HMG.
- Encourage industry-led responses: MTOs and banks could take together steps to bolster their cooperation and work together to devise market-based responses. Several avenues have been recently put forward by Oxfam¹². One possible important initiative that UK banks and MTO

¹² Adeso, Global Center on Cooperative Security, Oxfam, “*Hanging by a thread. The ongoing threat to Somalia’s remittance lifeline*”, February 2015. Accessed at https://www.oxfam.org/sites/www.oxfam.org/files/file_attachments/bn-hanging-by-thread-somalia-remittances-190215-en.pdf

could conduct jointly is a ML/TF risk assessment of the UK-Somalia corridor, and the preparation of a joint action plan to mitigate these risks while ensuring the continued flow of legitimate remittances. This solution would be part of the core elements, and would be coordinated by HMG. Similar industry-led steps could be considered in the UAE, building on what is understood as an emerging momentum within the industry there.

- **Raising awareness:** Awareness could be raised with the Somali diaspora communities on the topic of safety, integrity, and efficiency of remittance transactions. The remittances sender survey – commissioned by DfID and undertaken by the World Bank – can inform the design of activities aiming to increase migrants’ knowledge of remittances and financial products and opportunities to access financial services. This activity will follow the tested methodology developed by the World Bank for Project Greenback 2.0 on Remittances Champion Cities.¹³ There is also an option to consider capacity building for UK-based MTOs under this project, however, certain stakeholders have expressed that this may create competition issues in the market. This solution would be part of the core elements.

Details on UAE-based solutions:

31. One of the major concerns put forward by UK banks is that there is a lack of understanding of the clearing and settlement of the transactions in the UAE. As part of the scoping research for this project, a mission was undertaken to better understand the operational practices of MTOs in the UAE. MTOs expressed a commitment to share in-depth information on their practices and compliance systems. An observation during the mission was that there is significant scope for risk differentiation between the MTOs. Under UAE law, MTOs are required to provide regular reports to the UAE Central Bank on transactions undertaken and to have systems in place for end-to-end traceability of both senders and recipients for all remittance transactions. MTOs in the UAE stated that they carry out due diligence on all their clients and collect identification documents for persons and relevant commercial documents for traders and individual trade transactions, but the strength of such controls and quality of documents will vary by organization. When shown one of the information technology systems of a MTO, the team noted that the information collected, seemed comprehensive and that the system seemed to be integrated across all three jurisdictions of the UK-Somalia remittance corridor. Another contributing factor to consider in the risk-differentiation is that the MTOs in the UAE informed those visiting that the MTOs do not use cash for commercial accounts used for the import and export of goods, but pay out in checks, which presents a lower vulnerability. The remittances are used to support clearing of trade transactions, but do not function as trade financing.

- **Engagement with UAE MTOs:** It would be beneficial for all stakeholders in this remittance corridor to better understand the operations in the UAE; the UAE MTOs agreed that the industry needs to share information and communicate (notably with global banks) more effectively on the operational and compliance practices of the UAE MTOs. MTOs indicated their willingness to continue to engage with authorities and permit additional review of their systems by stakeholders, such as UK banks. This solution would be part of the core elements. As a result, this project would require a stepped up and more formal engagement with the UAE authorities.
- **Raising industry standards:** As noted above it was shared by the UAE MTOs that they are considering the development of industry led standards to strengthen internal controls and compliance for the sector. This could assist in creating risk-differentiation between the different

¹³ For more information, see <http://remittanceprices.worldbank.org/en/project-greenback-20-remittances-champion-cities>

MTOs. In this context, it appears that the current practices of many of the MTOs along the whole payment chain include collection of significant information on all the parties to the chain, at a rather granular level. The MTOs reviewed also indicate their information systems allow them to consolidate all the information, and make it available to compliance for analysis. These market based solutions could benefit from being implemented by MTOs across the board – in that respect, industry-led initiative, and regulatory/supervisory action in the UK and in Somalia, could useful ensure the emergence of a stronger level playing field. The stakeholders to this project could support the development of these standards. If initiated by the MTOs, this solution would be part of the core elements.

32. Still, as the transparency of end-to-end transactions remain a concern of the banks in the UK, the following solution could be considered in a contingency scenario:

- Introduce an Intermediary: Select an MTO entity that currently operates in the UK, who maintains bank accounts in the UK and is therefore subject to regulations in the UK, to establish operations or a customer relationship with a financial institution based in the UAE. This entity could act as “the Intermediary”. It is unclear if any of the aggregators, or the MTOs for which they aggregate transactions, have a presence in any of the UAE or hold bank accounts there. By establishing a presence in the UAE, the Intermediary would request the money to be transferred from the UK banks to its bank accounts in the UAE. The Intermediary will then take on the responsibility of clearing and settling the transactions in the UAE and carry out the appropriate due diligence on the senders in the UK, as well as the traders and clients in the UAE.
- This would be a way of consolidating the risk for the UK banks, since the Intermediary would operate in both the UK and the UAE. The Intermediary would be responsible for the financial flows, but also for maintaining the information on the clients and monitoring the trade transactions. It would be necessary to get the agreement of the UK banks to bank this Intermediary and to allow it to move the money between the UK and the UAE, subject to the banks’ satisfaction that the Intermediary will carry out adequate due diligence.
- This option would likely be a very costly exercise and early feedback indicates that this would be a contentious solution with the MTOs (who would not want to share information pertaining to their customers, including trade customers – with the Intermediary, who is their competitor). This solution would be part of the contingency element. At this time, the overall project budget proposal does not includes costs for this element.

Details on Somalia-based solutions:

33. The Somali Government has taken the lead in establishing a plan to support the flow of remittances to Somalia.¹⁴ The plan addresses some of the existing challenges pertaining to the regulatory and institutional framework for active supervision of MTOs in Somalia. Actions to address these challenges have been initiated as a priority. Efforts of donors are being coordinated in support of the plan of the Somali Government and the proposals made below are in line with those of the Somali Government. This will contribute to the longer-term regulatory and supervisory capacity building efforts in Somalia.

- MTO Regulations: In order to facilitate the immediate strengthening of the regulatory framework for the MTO sector, the World Bank is proposing to work with the CBS to draft MTO Operating

¹⁴ “*Formalizing the Financial Sector in Somalia – enabling safer flows of remittances and building foundations for the sector*”

Regulations that will be based on the draft AML/CFT Act, to which the WB has already provided technical assistance. The regulations are to include provisions for customer due diligence, recordkeeping, ongoing monitoring, reporting and internal controls. They would apply to all registered and licensed MTOs operating in Somalia. This solution would be part of the project's core elements, as well as support to the FGS Plan. The WB would also work with the CBS on the adoption of MTO Customer Registration Regulations, which would apply to customers of all MTOs to ensure a level playing field. Some basic forms of identification exist for a limited number of Somali citizens (passports, certain MTO-developed registration cards for frequent customers) but their penetration is currently very limited and would need to increase significantly to be deemed a reliable customer identification system. There is the potential to use mobile banking identification systems, using cell phones, to assist with customer identification. The regulations contemplated above will introduce customer registration requirements for the MTOs, with which all MTOs would need to comply. This could entail that clients are registered by the MTOs and that some form of a MTO identification document would be issued¹⁵. This solution would be part of the project's core elements, as well as support to the FGS Plan.

- **Financial Intelligence Unit:** To improve the institutional capacity and the development of a robust AML/CFT framework, the WB would provide accelerated support for the establishment of a Financial Intelligence Unit, in line with the requirements set out in the draft AML/CFT Act and Egmont principles. The support was already envisioned in the longer-term WB SCORE Project, and would be accelerated in support of the FGS plan, it is not included in the SCI budget proposal. Support would focus on administrative processes, training, capacity development and the development of a reporting mechanism. This solution would not be part of this project, but rather would be support to the FGS Plan. It is being highlighted here to emphasize the overlap of this project, the SCORE Project, and the support to the FGS Plan.
- **Supervision of MTOs:**
 - *Trusted Agent:* In addition, the WB would provide assistance for a temporary delegation of supervisory authority from the CBS to a firm to act as a "Trusted Agent" (TA). The TA would administer on behalf of (and in coordination with) the CBS on-site and off-site supervision to ensure that the MTOs and their agents comply with the regulations mentioned above and meet the requirements on an on-going basis. While TA supervisory activities will focus on MTO headquarters locations, the on-site and off-site activities may extend throughout Somalia. The role of the TA, in particular regarding any follow-up action to its supervisory findings, would be closely coordinated with the CBS, to meet the longer-term objective of enhancing the (regulation, supervision, and enforcement) capacity of the CBS. In principle, the TA would be appointed for 24-48 months. An exit strategy would be designed in advance in collaboration with the Somali Government. Likely this will involve a two-tiered approach: at first the TA will perform supervision and train CBS staff on-the-job, and in the second tier the CBS would perform supervision with the guidance of the TA. It is likely that the World Bank will undertake the procurement of the TA (Bank executed procurement) as opposed to a TA hired by the FGS (Recipient Executed procurement). This is in line with the overarching objective of this project which is to create confidence within the international community over the activities being undertaken in Somalia and to ensure that a credible TA with international expertise, is hired to operate in Somalia and to provide necessary capacity building to CBS staff.

¹⁵ To be determined via stakeholder engagement with Somali authorities.

- *Joint oversight committee*: To oversee the performance of the TA, it is proposed that an oversight committee would be set up in which the CBS, Ministry of Finance, HMG, IMF and the World Bank would be represented. This committee will ensure a space is maintained for open dialogue between the parties which will provide the incentives for the CBS to take appropriate action based on the findings of the supervisory activities of TA. The committee would not have any executive decision making powers (similar to the financial governance committee (FGC)) It would need to be examined if this is a possibility under the Financial Institutions Act 2012.¹⁶ This solution would be part of the project's temporary elements, as well as support to the FGS Plan.
- Advisory Council: During a multi-stakeholder roundtable at the 2015 Spring Meetings, Somalia Remittances Stakeholder Advisory Council (SR SAC), co-chaired by the WBG and CBS, was created to coordinate and communicate on activities and share information, in order to ensure there is no duplication of donor efforts in Somalia. The Advisory Council comprises authorities from the governments of Somalia, United Kingdom and United States, including representatives from the Ministry of Finance of Somalia, Central Bank of Somalia, UK Treasury, Department for International Development, US Agency for International Development, US Department of State, US Department of the Treasury, as well as the World Bank, International Monetary Fund and the Intergovernmental Authority on Development.

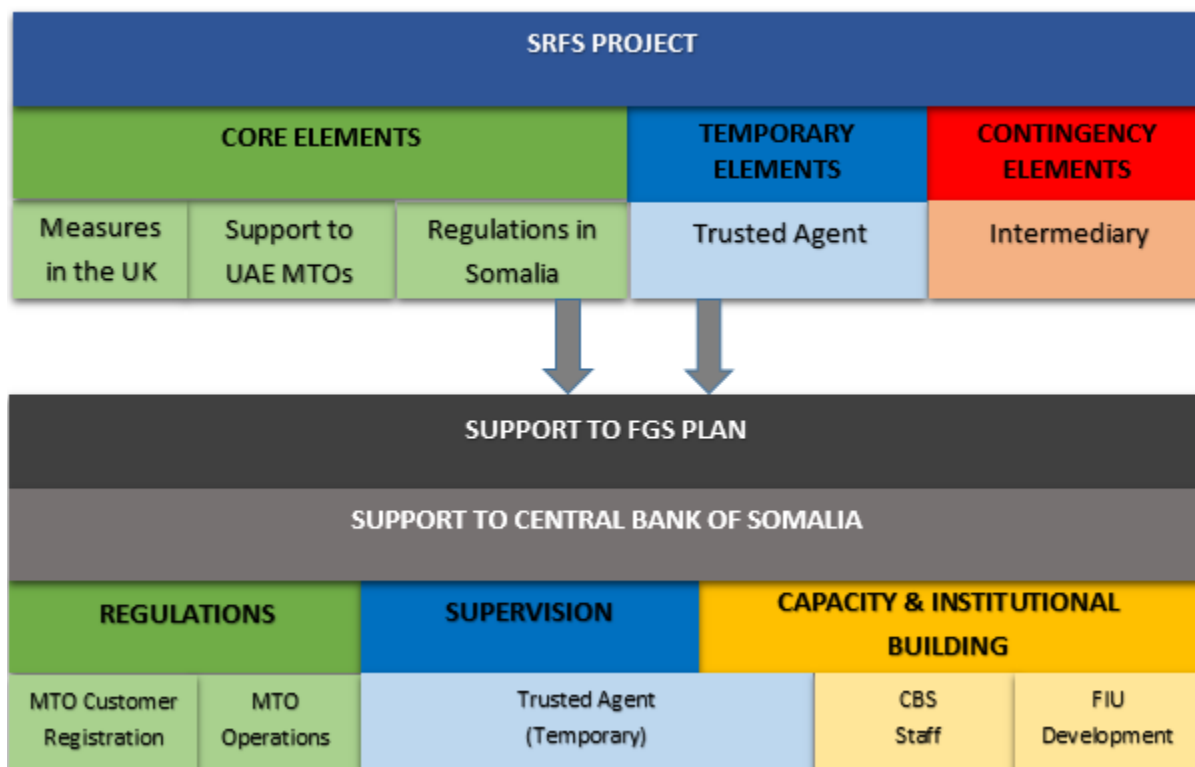
IV. PROPOSAL AND CRITICAL PATH

34. The project aims to tackle key challenges with the UK-Somalia remittance corridor until a sounder financial system is in place in Somalia, and to accelerate and support the development of that financial system. More specifically, this project is intended as an interim set of activities to support the supervisory role of the Central Bank of Somalia. The activities will also support the Somali Government's plan on the formalization of the Somali financial sector. Over time, the project has evolved to include both shorter-term and longer-term elements to strengthen the systems supporting the flow of remittances to Somalia. While the intended entry point of this project is through the Federal Government of Somalia, depending on progress made, it will be necessary to communicate with other regions of Somalia in order to expand the scope and reach of the activities to be covered under this project.

35. Upon consideration of the four different types of approaches and the various solutions proposed, it is the recommendation of the WB team that efforts be focused on addressing the challenges with the existing UK-Somalia remittance corridor. Figure 3 below summarizes the different solutions under the proposed project, which contains many activities that would also be considered support to the FGS Plan. The overall project is referred to as the SRFS Project, which will contain core, temporary, and contingency elements. The core and temporary elements should be implemented regardless of a significant remittance flow disruption, and the contingency elements should be implemented only if there is a significant remittance flow disruption. The SRFS Project would run for 30-54 months (6 months of design and procurement, 24 months of implementation + option to extend an additional 24 months of implementation).

¹⁶ A similar joint board was set up to oversee the implementation of public financial management reforms. The Financial Governance Committee was established in 2013, in which the President's policy unit, and designates of the IMF, World Bank and African Development Bank were represented. This committee does not have executive powers, but drives important reviews of concession agreements and contracts.

Figure 3: Solutions of the SRFS Project / Support to the FGS Plan



35. The approach of addressing existing challenges has the advantage of being the easiest and quickest to adopt, given the pre-existing market construct. It is also the least disruptive proposal and maintains the long standing trading relationships between the UAE and Somalia. In addition, it will also complement the ongoing work of the World Bank and other donors working in Somalia.

36. In 2012, the World Bank formally re-engaged in Somalia and, through the mobilization of a substantial 10-year Multi Partner Fund, has developed a priority set of interventions designed to strengthen economic institutions and expand economic opportunity. The flagship areas of active World Bank support are in financial and economic governance including work on public financial management and the provision of recurrent cost support through the budget, and capacity injection – all three areas at both the federal and sub-national level.

37. The World Bank's financial sector work in Somalia has targeted improvements to the financial sector's institutional environment to facilitate private sector participation. Initial focus was limited to Somaliland but has since expanded to supporting the Central Bank of Somalia, following the establishment of a recognized federal government in Somalia. Starting in February 2014, the CBS, with advice and technical assistance from the World Bank and other agencies, began implementation of an 18 month strategic roadmap focused on high-priority tasks including establishing and maintaining correspondent bank accounts by CBS, strengthening CBS banking and accounting functions, financial system supervision, stakeholder engagement and communication. Technical assistance was also provided on drafting regulations on registration and licensing of MTOs under the Financial Institutions Act of 2012. The World Bank support to the CBS also includes a financial integrity pillar, which is focused on activities to support the Somali authorities to begin to establish an AML/CFT framework in line with

international standards. Finally, the World Bank has led the establishment and operationalization of a Financial Governance Committee (FGC), which convenes the Minister of Finance, Governor of the Central Bank with the President’s Office and Prime Minister’s Office to review high-profile issues of financial governance risk. After one year of its work, the FGC has been able to support the government in its asset recovery process (with additional support from the Stolen Asset Recovery Initiative), review 12 signed and planned strategic concessions contracts and provide targeted advice to the Central Bank. The FGC is envisaged to continue for a further one year period, as the IMF and the authorities prepare to initiate a Staff Monitored Program (SMP).

38. The critical path set out below (Table 1), details each of the proposed activities by jurisdictional location of the deficiency, including identifying the responsible parties to lead and implement the project, as well as the anticipated start date of the activity and timeframe.

39. The proposed solution is to be dealt with in two phases. Once a decision is taken by the WB and the UK authorities jointly on the proposed solutions, the drafting and procurement phase can begin. The implementation phase will follow the drafting and procurement phase.

- **Drafting and procurement phase:** This phase will first involve technical assistance to the Somali government for the drafting of regulations for the MTO sector and the procurement of the TA. As mentioned above, it is likely that the World Bank will undertake the procurement of the TA (Bank executed procurement) as opposed to a TA hired by the FGS (Recipient Executed procurement). Subject to the decisions made on how best to incorporate customer identification measures within Somalia – this could also include the development and testing of an appropriate customer registration framework.
- **Implementation phase:** The implementation phase can only be achieved once the drafting and procurement phases have been completed. The key component in the implementation phase is the work conducted by the TA. In Somalia, this phase would focus on the MTOs that are currently registered and/or licensed by the CBS.

40. The work of the TA will be evaluated on an ongoing basis. A comprehensive evaluation of the various components will be planned for in month 10 of the implementation phase. While it is too early to propose potential outcomes for evaluation, listed below are indicators which could be used to assess the effectiveness of the TA:

<i>Trusted Agent</i>
<ul style="list-style-type: none"> • Number of CBS staff trained in on-site and off-site supervision • Number of on-site reports • Number of off-site reports • Number of MTO customers registered • Number of breaches of regulation identified

Table 1: Critical Path

	ACTIVITY	LEAD	IMPLEMENTATION	START DATE	TIME FRAME
CORE/ TEMPORARY ELEMENTS					
UK					
	Continuing to build efforts to strengthen UK MTO AML/CFT compliance (core element)	HMRC	HMRC	Continuation of ongoing compliance program	Ongoing – building on existing compliance program
	Provision of detailed information to the banks on the terrorist financing risks associated with Somalia and money remitters operating there to UK banks (core element) <ul style="list-style-type: none"> • Incorporate findings from Project Greenback¹⁷ 	NCA	NCA, FCO (on Somalia), NTFIU, the Met, and FCA	1 May	ongoing
UAE					
	Multi-stakeholder consultations (core element) <ul style="list-style-type: none"> • Information sharing on operational and compliance practices by MTOs in UAE • Supporting industry led initiatives to strengthen internal controls and compliance procedures 	WB	All	1 September	2 – 6 months
Somalia					
	Drafting of regulations (core element) <ul style="list-style-type: none"> • MTO Customer Registration Regulations • MTO Operational Regulations <ul style="list-style-type: none"> ○ Customer and recipient due diligence ○ Selection of agents by MTOs ○ Record-keeping ○ Monitoring ○ Reporting ○ Internal Controls • Supervision procedures 	WB CBS	WB CBS	1 July	2 – 4 months (for regulations and procedures)

¹⁷ Project Greenback 2.0 aims at increasing efficiency in the market for remittances through an innovative approach by promoting change inspired by the real needs of the ultimate beneficiaries of international money transfers: the migrants and their families at home.

	Hire TA (temporary element) <ul style="list-style-type: none"> • Delegation of authority from CBS to TA • Draft TORs for TA¹⁸ <ul style="list-style-type: none"> ○ Number of supervisors ○ On/off-site supervision ○ On-the-job training of CBS staff ○ Monitoring and supervision plan for the TA by a board ○ Transition to CBS led supervision • Draft procurement documents¹⁹ • Select TA in consultation with CBS • Finalize hire of TA 	WB	WB	1 July	4 – 6 months
	TA implements supervision (temporary element) <ul style="list-style-type: none"> • On/off-site supervision • On-the-job training of CBS staff • Reports to the board 	TA	TA CBS WB	1 October ²⁰	ongoing
	Implement customer registration measures (core element) <ul style="list-style-type: none"> • Training/awareness raising MTOs • Supervision on registration 	TA	Somali MTOs	1 October	ongoing
CONTINGENCY ELEMENTS					
UAE					
	Introduce an Intermediary (contingency element) <ul style="list-style-type: none"> Selection process for UK MTO entity to fill the role Draft TORs Finalize selection Intermediary to establish presence in UAE 	DfID	DfID HMRC HMT WB (as advisory)	Contingency	2 – 6 months
	Intermediary to begin centralized process of transactions and information	Selected MTO	Selected MTO	Contingency	ongoing

¹⁸ The TA will be hired to conduct the on and off-site supervision of the MTOs, including ensuring compliance with the MTO customer registration and MTO operational regulations.

¹⁹ Completion of procurement procedures may take from 4 to 6 months, depending on the solutions, complexity of the tasks and type of contract required.

²⁰ The 1 October date and those thereafter in this section assume a 4-month time frame for hiring. Note it could take up to 6 months.

V. RATIONALE FOR WB ENGAGEMENT

41. The objective that underlies the WB engagement in this project is to ensure access to the already limited financial services for Somali households. MTOs facilitate the flow of remittances amounting to at least USD 1.2 billion a year, which exceeds ODA (USD 800 million a year), and is relied on by Somali households to cover basic expenses, such as food, medical care, housing and education. For the urban population, two thirds reported that remittances are their primary source income, and that 80% of start-up capital of businesses (FAO 2013). If such flows should be interrupted, this would have a very destabilizing effect on the Somali economy, which could have implications for the security and stability of the region. Alternatively, without an intervention to facilitate the continuation of the flows the transfer of money could move underground. This would increase opacity of the flows, and increase the risk of abuse for illicit purposes such as terrorism financing, money laundering and sanctions evasion. In addition, this project can form an entry point towards building the supervisory infrastructure and capacity that is needed for a sustainable financial sector development in Somalia.

42. The proposed solutions require the WB to take on different roles – ranging from convening to advising and/or implementing– all of which are well aligned with the strategic objectives and priorities of the overall engagement.

- **Convening:** At this stage, the WB reputation as a trusted global partner to UK, Somali and US stakeholders from the public and private sector enables us to hold effective formal and informal consultations on the design, which should increase the likelihood of achieving suitable and well-supported solutions. The convening power of the WB would enable us to continuously consult with the stakeholders and assess the needs, as the implementation of the solutions would take place.
- **Advising:** The WB is also well positioned to take on an advisory role in the design and implementation phases of the project, considering our technical experience in designing payment systems, AML/CFT frameworks, and other knowledge of global solutions.
- **Technical assistance:** For the regulation and supervision issues in Somalia, the WB could use its expertise and authority to provide technical assistance. This technical assistance would contribute to longer-term capacity, and present an opportunity to align the work with longer term WB assistance to Somalia.

VI. RISK AND RISK MANAGEMENT MEASURES

43. This section will explore risks and risk management measures for the World Bank as the implementing partner and in the context of the project.

Risks and Risk Management Measures for the World Bank

44. **Security:** Security is the major concern and challenge for development assistance in Somalia. Security poses a risk both for Bank staff security, and Bank contractors, as well as for project implementation and sustainability. The resulting access and movement restrictions, while necessary can constrain the ability for effective overseeing of project implementation.

- **Management:** In implementing the project the Bank team will operate in close consultation with the corporate security department in the Bank's Goods and Services Department (GSD) and under the UN umbrella provided by the Department of Safety and Security. GSD has already undertaken assessment missions to the three regions and has issued advice which is being

implemented and a follow-up mission is under preparation by GSD to update the information, review what other agencies are doing and assess prospects for longer-term presence on the ground. The procurement process to engage a TA will involve GSD Corporate Security and LEGIO to ensure the contracted party is aware of the risks and has taken the appropriate measures. This is in line with the Bank's standard practice in Somalia.

45. **Political Issues:** On the political side, this issue is receiving significant attention in the UK. The UK government has publicly communicated on their efforts to address this issue (specifically working with the World Bank on a "Safer Corridor Pilot/Initiative"), which has also created additional inquiries from the press. In the US, members of Congress, particularly from the state of Minnesota which has a large Somali population, have expressed significant interest in the issue, and the World Bank was asked to provide a background briefing for Congressional staff the first week of March 2015. The same Congressional staff had also requested a briefing from US government officials on February 26, 2015. The UK and the US participated in a multi-stakeholder roundtable on remittances to Somalia during the Spring Meetings 2015, and all parties agreed to be part of a Somali Remittances Stakeholder Advisory Council, created to coordinate and communicate on activities and share information. The Advisory Council comprises authorities from the governments of Somalia, United Kingdom and United States, including representatives from the Ministry of Finance of Somalia, Central Bank of Somalia, UK Treasury, Department for International Development, US Agency for International Development, US Department of State, US Department of the Treasury, as well as the World Bank, International Monetary Fund and the Intergovernmental Authority on Development.

- **Management:** Continue to monitor political realities in UK and US, which could have potential project implications. Convene regular meetings of the Advisory Council to ensure activity coordination. Coordinate communication strategy between the World Bank, UK and US.

46. **Ownership by the Somali authorities:** Somali authorities are on-board with the proposal at a policy level and recognize the importance to move quickly – with two conditions: 1) to have CBS fully a part of the solution, and 2) to ensure that the project bolsters longer-term objectives. This calls for an intensified engagement and identification of technical solutions bringing both credibility to the supervision function and integration with the short term and longer-term institutional set-up in Somalia.

- **Management:** Continue the close coordination with all stakeholders, including all World Bank projects and CMU staff. Following the announcement by the authorities of their own plan, and their creation of a special task force, the team has reshaped the proposed engagement and its presentation to align it, as much as possible, with the FGS plan – in terms of substance, timetable and processes. Communication will be critical in that respect, to stress that the WB engagement in Somalia focuses on supporting the authorities' own plans. To ensure buy-in to the activities, the WB and the CBS signed a memorandum of understanding on June 30, 2015 (Annex 1 to this Concept Note).

47. **Reputational risk:** The core challenge in the current situation is the management (or avoidance) of the regulatory risk, while at the same recognizing that the terrorism financing and financial crime risks will remain high. Most of the proposed solutions aim to reduce the financial crime risk and improve the conditions for its mitigation, through increased transparency, more risk differentiation and more credible due diligence along the corridor. Such steps can also help improve the cost/benefit profile of the provision of banking services. However, this cannot completely eliminate regulatory and reputational risk and exposure. This risk will ultimately need to be "owned" by some player. Regardless of the measures taken under this project, there is still the possibility that the corridor may be misused and actors may be exposed to regulatory action. Should it be decided that the WB play a role in the oversight of the proposed TA, it may be exposed to some liability for what those entities do, what they may find, and how they operate.

While improved transparency may help in risk management, absent the development of functioning and well-regulated and supervised financial system in Somalia it will not be enough.

- **Management:** The project proposes that the UK oversees the activities taking place in the UK. There are some elements of shared responsibility, namely that the WB has a key role to play in the outreach to UK banks together with the HMG authorities, and that the WB shares a common objective to raise awareness of the project activities. For the activities in Somalia, it is proposed that the WB will be responsible for the procurement of the TA, and that an oversight committee (CBS, Ministry of Finance, HMG, IMF and World Bank) is set up. The objective of this committee is to ensure a space is maintained for open dialogue between the parties which will provide the incentives for the CBS to take appropriate action based on the findings of the supervisory activities of TA.

48. Bank executed – v- Recipient executed Procurement: Subject to extensive discussions, it has been recommended that the World Bank will undertake the procurement of the TA (Bank-executed procurement) as opposed to a TA hired by the FGS (recipient-executed procurement). This is in line with the overarching objective of this project which is to create confidence within the international community over the activities being undertaken in Somalia and to ensure that a credible TA with international expertise, is hired to operate in Somalia. However given the high risk nature of this project, there are a number risks with the Bank undertaking the procurement of TA, including security concerns, ensuring the hiring of a credible TA and effectiveness of the work undertaken by the TA.

- **Management:** Taking into consideration, the risks involved in a Bank-executed process, the ultimate decision of whether this will be a Bank-executed or recipient-executed will be undertaken by Bank Management.

Risk & Proposals for Risk Management Measures for the Activities

49. The risks for the activities (as laid out in the critical path in Table 1) for this project are outlined below in Table 2. The table also contains proposals for risk management measures. The lead for the different activities will bear the ultimate responsibility for managing the risks of the different elements.

Table 2. Risks and Proposals for Risk Management Measures for the Activities

MILE	ACTIVITY	LEAD	RISK	PROPOSALS FOR RISK MANAGEMENT MEASURES
CORE/ TEMPORARY ELEMENTS				
UK				
	Continue efforts to strengthen UK MTO AML/CFT compliance	HMRC	Even with increased UK MTO capacity, banks still have limited business incentives to (re-) engage with MTOs	HMG to coordinate
	Provision of detailed information to the banks on the terrorist financing risks associated with Somalia and money remitters operating there to UK banks <ul style="list-style-type: none"> Incorporate findings from Project Greenback 	NCA FCO/DfID (Country risks)	HMRC cannot share information on individual MTOs due to legislative restrictions Could cause uneven playing field for MTOs Does not change banks' de-risking decision due to concerns of terrorist financing risks and inadequate regulation and supervision Somalia	HMG to coordinate
UAE				
	Introduce an Intermediary (contingency element)			
	Selection process for UK MTO entity to fill the role	DfID	There is no current market player interested in fulfilling this role Selecting one MTO to fulfill this role could cause uneven playing field for MTOs	Consult with current market players; Allow flexibility to have more than one MTO fulfilling this role (for competition)
	Intermediary to begin centralized process of transactions and information	Selected MTO	There is no current market player interested in fulfilling this role Event with an MTO in this role, the banks are not willing to bank this entity There may be legal restrictions on the aggregating of customer information in the UAE and sharing it cross-border or with different financial institutions	Consult with current market players; Engage banks in the selection process
	Multi-stakeholder consultations <ul style="list-style-type: none"> Information sharing on operational and compliance practices by MTOs in UAE 	WB	Despite increased transparency on end-to-end users of the corridor, UK banks may still have limited business incentives to (re-) engage with MTOs Does not change banks' de-risking decision due to	This is an effort-based proposal, where the greatest degree of information sharing is the objective. No risk management measures are available to the WB

			concerns of terrorist financing risks and inadequate regulation and supervision Somalia	
Somalia				
	Drafting of regulations (integral element) <ul style="list-style-type: none"> • Delegation of supervisory authority • MTO Customer Registration Regulations • MTO Operational Regulations <ul style="list-style-type: none"> ○ Customer and recipient due diligence ○ Selection of agents by MTOs ○ Record-keeping ○ Monitoring ○ Reporting ○ Internal Controls • Supervision procedures 	WB CBS	Somali authorities decide not to delegate supervisory authority	Close collaboration with Somali authorities in drafting of the proposals. Arrange face-to-face meetings with authorities during Spring meetings to maintain momentum. Signed MoU between WB and CBS.
	Hire TA (integral element) <ul style="list-style-type: none"> • Delegation of authority from CBS to TA • Draft TORs for TA <ul style="list-style-type: none"> ○ Number of supervisors ○ On/off-site supervision ○ On-the-job training of CBS staff ○ Monitoring and supervision plan for the TA by a board ○ Transition to CBS led supervision • Select TA in consultation with CBS • Draft procurement documents • Finalize hire of TA 	WB	Unable to find suitable TA Somali authorities refuse selected vendor	Coordinate with CMU, obtain input from other World Bank projects Involve Somali authorities throughout procurement process
	TA implements supervision (integral element) <ul style="list-style-type: none"> • On/off-site supervision • On-the-job training of CBS staff • Reports to the board 	TA	Security risks to TA TA unable to coordinate with CBS TA is unable to enforce compliance with regulations TA is unable to coordinate efforts outside of Mogadishu and not in Somaliland and Puntland	World Bank security guidelines will be updated regularly The selected firm employs local/regional staff. The board will help manage relationship between TA and CBS
	Implement customer registration measures (integral element) <ul style="list-style-type: none"> • Training/awareness raising MTOs • Supervision on registration 	TA	Registration measures will not solve customer identification concerns. Registration measures create false sense security	Measures will be adopted based on the international practices for customer identification where the formal ID infrastructure is still developing
CONTINGENCY ELEMENTS				

UAE				
	Introduce an Intermediary (contingency element)			
	Selection process for UK MTO entity to fill the role	DfID	<p>There is no current market player interested in fulfilling this role</p> <p>Selecting one MTO to fulfill this role could cause uneven playing field for MTOs</p>	<p>Consult with current market players;</p> <p>Allow flexibility to have more than one MTO fulfilling this role (for competition)</p>
	Intermediary to begin centralized process of transactions and information	Selected MTO	<p>There is no current market player interested in fulfilling this role</p> <p>Event with an MTO in this role, the banks are not willing to bank this entity</p> <p>There may be legal restrictions on the aggregating of customer information in the UAE and sharing it cross-border or with different financial institutions</p>	<p>Consult with current market players;</p> <p>Engage banks in the selection process</p>

VII. BUDGET²¹

CORE ELEMENTS			
Support to UAE MTOs	WB Staff time	\$30,000.00	\$50,000.00
	Travel costs	\$20,000.00	
Regulations in Somalia	WB Staff time	\$80,000.00	\$180,000.00
	Travel costs	\$100,000.00	
SUBTOTAL CORE ELEMENTS			\$230,000.00

TEMPORARY ELEMENTS			
<i>Project Preparation</i>			
Procurement Process for TA	WB Staff time To include 2 project staff drafting procurement documents, 2 dedicated procurement staff overseeing procurement process, 3 project staff as procurement reviewers.	\$50,000.00	\$50,000.00
<i>Trusted Agent</i>			
TA implements supervision – year 1 3 TA expert staff - 70 working days in Somalia 2 TA expert staff - 250 working days in Somalia	WB staff time	\$61,000.00	\$900,000.00
	Vendor cost (3 staff * 900 per day rate * 70 days = 189000) (2 staff * 300 per day rate *250 days = 150000)	\$339,000.00	
	Security cost (2000 per day * 250 for full time and part time staff work days = 500,000)	\$500,000.00	
TA implements supervision – year 2 2 TA expert staff - 50 working days in Somalia 1 TA expert staff - 250 working days in Somalia	WB staff time	\$60,000.00	\$725,000.00
	Vendor cost (2 staff * 900 per day rate * 50 days = 90000) (1 staff * 300 per day rate *250 days = 75000)	\$165,000.00	
	Security cost (2000 per day * 250 for full time and part time staff work days = 500,000)	\$500,000.00	
Optional TA implements supervision – year 3 2 TA expert staff - 50 working days in Somalia 1 TA expert staff - 250 working days in Somalia	WB staff time	\$60,000.00	\$725,000.00
	Vendor cost (2 staff * 900 per day rate * 50 days = 90000) (1 staff * 300 per day rate *250 days =	\$165,000.00	

²¹ The numbers provided in the budget table are in US dollars (\$). This project will be funded by DfID, partly through funding paid into HiFi (the payment systems trust fund) and partly through funding paid into the Somalia Multi Partner Fund (SMPF) (with a separate infusion specifically for this project).

	75000)		
	Security cost (2000 per day * 250 for full time and part time staff work days = 500,000)	\$500,000.00	
Optional TA implements supervision – year 4 2 TA expert staff - 50 working days in Somalia 1 TA expert staff - 250 working days in Somalia	WB staff time	\$60,000.00	\$725,000.00
	Vendor cost (2 staff * 900 per day rate * 50 days = 90000) (1 staff * 300 per day rate *250 days = 75000)	\$165,000.00	
	Security cost (2000 per day * 250 for full time and part time staff work days = 500,000)	\$500,000.00	
Implement customer registration measures (This cost is dependent on whether the design of the customer registration measures builds on pre- existing efforts of MTOs or implements a new framework for customer identification.)	WB Staff time	\$50,000.00	\$350,000.00
	Vendor cost	\$300,000.00	
	Security cost (included in security costs above)		
SUBTOTAL TEMPORARY ELEMENTS	2 years		\$2,025,000.00
SUBTOTAL TEMPORARY ELEMENTS	2+2 years		\$3,475,000.00
TOTAL CORE AND TEMPORARY ELEMENTS	2 years		\$2,255,000.00
TOTAL CORE AND TEMPORARY ELEMENTS	2+2 years		\$3,705,000.00