DE-RISKING: ITS KEY DRIVERS, IMPACT ON THE CARIBBEAN AND THE WAY FORWARD

The Caribbean Region has been experiencing the manifestation of the negative impacts of the de-risking phenomena immediately following the financial crisis of 2009. The small open economies which rely heavily on the international payments systems to facilitate remittances, trade flows, and foreign direct investments have been the most severely affected Region in the world. Developing more transparent compliance structures, balancing compliance and costs and improved use of technical tools such as Know Your Customer and Legal Entity Identifier are among some of the key measures which should be engaged to fight this scourge.

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1. Introduction
1.1 Purpose and Objective

This white paper, on “De-risking: Its Key Drivers, Impact on the Caribbean, and the Way Forward”, is being completed to satisfy the requirements for the Association of Certified Anti-Money Laundering Specialists (ACAMS)—Audit designation.

The de-risking phenomena have affected a wide range of products/services and financial and other institutions across the Caribbean region, including small- and medium-sized domestic banks, building societies, off-shore businesses, money services businesses, and other remittance service providers, small- and medium-sized exporters, retail customers, international companies, and gambling/e-gaming entities. However, the most significant effect of de-risking has been the loss of correspondent banking relationships (CBRs), unevenly spread across the Caribbean.

Against this background, the primary focus of this paper will be the de-risking of correspondent banking relationships.

1.2 Background Information
1.2.1 Definition and Characteristics of De-risking

The Financial Action Task Force (FATF) has defined de-risking as "the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risk," with the risk being the customer that poses higher-than-average Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) risk, and whether or not the processing of a transaction may result in violation of a sanctions regime.¹

De-risking has taken various forms, but the three key components that have proven to be the most challenging are: The termination of CBRs resulting in significant loss of access to international payments systems, which, in turn, has had systemic and destabilizing effects on some economies. The withdrawal and restriction of banking services to money services businesses (MSBs) has had a significant destabilizing impact on the developing and underdeveloped economies, which are heavily dependent on the flows from remittances to help eliminate poverty and achieve

developmental goals. Finally, the denial/closure of bank accounts and restriction of access to financial services to some categories of individuals and organizations has resulted in the limiting of financial integration.²

1.2.2 Why Has De-risking Come About?

The de-risking phenomena rose to prominence, post-financial crisis, in response to international regulatory reforms, which have caused global banks to reduce their exposure to the riskier jurisdictions. Among some of the critical changes was the issuance of the "Wolfsberg Standards" on global banking, issued by the Wolfsberg Group on AML/CFT. Additionally, de-risking has also resulted from economic concerns, whereby governments have taken increased punitive action to penalize banks found to be facilitating the flow of the illicit proceeds of crime. The dissuasive fines have forced the global banks to implement more stringent compliance measures, resulting in astronomic compliance cost and low-risk appetite, which have impacted negatively on the profitability of the banks.³

1.2.3 What Are Correspondent Banks?

Correspondent banking, according to the Wolfsberg Anti-Money Laundering Principles for Correspondent Banking, is the provision of banking services, including current or another liability accounts by foreign banks (the correspondent bank) to other financial institutions, including affiliates in different jurisdictions (the respondent bank). It is used to facilitate the execution of third-party payments, trade finance services, cash clearing, liquidity management, and short-term borrowing in a particular currency. The correspondent bank, therefore, acts as the agent for the respondent banks' customers abroad. A correspondent/respondent banking relationship is ongoing and established through bilateral agreements between the two banks.⁴


1.2.4 Importance of CBRs

Correspondent banking is fundamental to the global payment system, since it facilitates the settlement of financial transactions across borders, which play a vital role in economic development and trade. It allows companies and individuals to safely move money around the world, thereby fostering the success of international business and financial inclusion. Besides, most payment solutions do not require a bank account at the individual customer level for remittances, but are dependent on correspondent banking to facilitate the transfer of funds. Additionally, correspondent banking permits smaller banks to facilitate payment and settlement instruments, including letters of credit, which are useful when companies embark on new trade relationships or in instances where uncertainty surrounds the creditworthiness of counterparties, since the unknown risk involved can be hedged to the confirming banks.  

1.2.5 The Vulnerability of the Caribbean to De-risking

Due to its strategic location between North and South America and the perception of it as a significant transshipment point for illicit drugs, firearms, and human smuggling, the Caribbean region has been labeled high risk. Additionally, most of its economies are considered highly cash-intensive, and the growth and development of the off-shore financial sector have contributed to the perception of the region as highly vulnerable to financial crimes. Several countries within the region are also deemed tax havens/secrecy jurisdictions, where legitimate business activities can be conducted, but can also be misused by criminals, since tax havens usually prohibit the disclosure of clients' information, including information on the directors and beneficial owners of companies. Therefore, deposits can be made in secrecy havens with anonymity and then transferred globally. Such practices can contribute to widespread de-risking, since they serve as enablers of financial crimes.  

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2. Context and Discussion

2.1 Causes and Drivers of De-risking

2.1.1 Overview

Enhanced regulatory pressures, rising compliance costs, and the destabilizing effects of enforcement actions and fines have resulted in financial institutions increasingly withdrawing from business with customers or regions perceived to carry a higher level of risk. Driven by the concern that incorrect compliance decisions could result in reputational and regulatory costs, financial institutions have grown more risk averse over the past several years.

The factors leading to the withdrawal of CBRs, which are numerous and interrelated, are individual business decisions made by correspondent banks based on their profitability and AML/CFT risk assessments. The profitability consideration takes into account income and the cost of capital, while the risk assessment component focuses on the AML/CFT risk associated with specific business relationships versus the bank's risk tolerance level.  

According to the World Bank 2015 study, based on the large international banks surveyed in the Caribbean region, know your customer (KYC) and AML/CFT concerns were among the highest-ranked key drivers of de-risking, while local and regional banks identified the lack of profitability associated with some correspondent banking products as the most significant key driver. The majority of the regulators across the region were of the view that the lack of profitability posed by some CBRs was the primary driver.

Additionally, unique to the Caribbean, the ownership structure of the banks in the region appears to have been a key factor that was considered when making de-risking decisions.

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2.1.2 Ownership Structure of Banks

The banks operating in the Caribbean can be classified into three categories: foreign banks, large indigenous banking groups, and small indigenous banks.

a. Foreign Banks

Foreign banks are mainly subsidiaries/branches of large North American banking groups, including Canadian banking institutions that have a strong presence in the region. Their status of being foreign owned, has positioned these banks to capture a significant portion of the cross-border transactions conducted between the region and the rest of the world.

Further, these banks have also benefited from the strong risk and management oversight functions of their parents, which include North American board members who bring wide-ranging experience to the regional operations and a rotation of managers from North America to fill key executive and senior management positions. Reporting on financial performance and compliance issues is also more frequent and comprehensive, and the banks are able to take advantage of all other resources and technical expertise, residing within their parent companies. Hence, the foreign banks have the distinct advantage of benefiting from their parents' reputation when establishing and maintaining CBRs. Even if the CBRs of the foreign banks are terminated, they can still process their cross-border transactions through the accounts of the parent bank, thereby mitigating the risks associated with the loss of CBRs.

b. Large Indigenous Banks

Most of the large indigenous banking groups in the Caribbean came into existence as a result of the divestment of foreign bank branches and subsidiaries. The large indigenous banking groups were mainly regionally owned and traditionally operated within a few territories with small balance sheets. However, today, some of the large indigenous groups have evolved into major regional financial

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conglomerates with operations in multiple jurisdictions and balance sheets surpassing the billion-dollar mark, which accounts for a significant portion of the market share of individual jurisdictions, and they have even become competitors to the foreign-owned institutions. Due to their size, many of these institutions were able to capture a significant portion of cross-border transfers, thereby allowing for the flow of large volumes of transactions through correspondent bank accounts.

Over the years, the operations of the large indigenous banks have become more integrated as a result of stronger head office oversight, risk management functions, and the consistency in business policies and processes across jurisdictions. The volume of cross-border transactions processed by the institutions is also on par with those of the foreign banks. Along with strong controls, this meets the requirement of the correspondent banks' profitability motive, which takes into account the risk versus return posed by the relationship, thereby making a compelling case to justify the maintenance of the CBRs for the sizeable indigenous banking groups.

c. Small Indigenous Banks
On the other hand, small indigenous banks appear to have been more vulnerable to the loss of CBRs, since they are unable to have access to and provide the full range of services similar to those associated with the resources and expertise enjoyed by the more significant players within the financial sector. In addition, they have no dominant market position, and their operations are confined to few jurisdictions in the region. Further, in many instances, the AML/CFT frameworks of these institutions are weaker than those of their larger counterparts due to weak board and risk management oversight functions. All of these concerns, in addition to the small volume of transactions being processed, are vital factors that are considered by correspondent banks when making decisions on whether to terminate CBRs, since in their view, the risk posed by maintaining the relationships with small indigenous banks far outweighs the benefits to be derived from the relationships.
2.1.3 Profitability-Related Drivers

a. **The small scale of business and low profitability** takes into account the cost-profit analysis of doing business versus the perception of excessive risk-taking from maintaining CBR. Enhanced regulatory requirements in relation to KYC and know your customer's customers (KYCC) have increased the costs for correspondent banks, especially those maintaining relationships in high-risk jurisdictions. KYCC has proven to be a very costly and intensive exercise for correspondent banks, and trust issues have also arisen in relation to the implementation of more stringent AML/CFT controls between perceived high-risk respondents and their correspondent banks. This has often led to the decision to terminate CBRs, a decision that appears rational in many cases since the profits derived from maintaining such accounts do not adequately offset the risk of banking those customers; hence, there is no value in maintaining CBRs with such customers.

b. **The increasing cost of compliance also reduces the profits** of correspondent banks: as regulatory changes and additional reporting requirements evolve, cost of compliance is driven upwards. Over the last decade, the majority of changes have occurred as a result of stricter and more active enforcement of AML/CFT regulations, which have become more extensive and are complemented by countering the financing of terrorism, weapons of mass destruction, trafficking in persons, human smuggling, and tax transparency requirements, among others. Additionally, cost of compliance is also escalated by significant fines and penalties, which are levied against banks for lax compliance screening and risk-management systems due to the passage of the United States Dodd-Frank Act during 2010. These factors, along with small volumes of business, have resulted in banks being unable to benefit from economies of scale; hence, decisions are made to de-risk small-sized respondents in small territories.11

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c. Reputational issues and increased cost of capital: apart from the imposition of hefty fines, AML/CFT non-compliance has more severe consequences, including the restriction of certain classes of banking activities, cease and desist orders, and even revocation of the financial institution's license. These enforcement actions and enhanced regulatory oversight automatically increase the reputational risk of the institution. In most cases, the bank's capability to withstand the enforcement actions adversely affects its relationship with investors and has a negative impact on its share price. These actions also negatively impact the financial position of banks, since regulatory powers are exercised to direct banks to boost their capital, liquidity, and solvency levels in order to prevent failure of the institutions similar to that of the 2008 financial crisis.12

De-risking is also accompanied by negative publicity, since the perception is that the correspondents deny its clientele and disadvantaged sections of the population essential financial services, and this adds to the adverse perception that financial institutions were responsible for the financial crisis of 2008.

2.1.4 Risk Assessment-Related Drivers

Here, correspondent banks usually take two major factors into consideration when assessing the risks posed by respondents; that is, their risk-tolerance limits, their perception of the risks posed by the CBR, and their capability to manage those risks. The correspondent banks' risk-tolerance limits are established based on their implementation of the FATF Recommendation No. 1 on the application of the risk-based approach, the extent of the perception that regulatory expectations are clear and consistent, and the view of the eminent enforcement and remedial and supervisory actions.


12 Centre for International Governance and Innovation. (2017). De-risking Drivers, Effects and Mitigation
American regulators have intensified their supervisory efforts after the financial crisis of 2008, because they were blamed for lax oversight of the financial institutions before the financial crisis. It was the view that banks were not held fully liable for their role in the financial crisis. Therefore, this enhanced supervisory oversight, which is being exercised, particularly in relation to AML/CFT, may be an attempt to prevent similar recurrences and penalize banks for misconduct. In response, correspondent banks have significantly reduced their risk-tolerance levels, which has resulted in wholesale de-risking of entire sections of their clientele.

Generally, disclosures are not made by financial institutions on the methodologies used for de-risking, and the criteria used vary across the industry. However, the major reasons, most frequently identified for de-risking, are a reduction in risk-tolerance levels and increasing level of AML/CFT scrutiny by FATF and FATF-styled regional bodies.

2.2 Experience and the Impact of De-risking on the Caribbean

2.2.1 Impact/Effects of the Loss of CBRs in the Caribbean

The findings of the World Bank study have indicated that the Caribbean region appeared to be the most severely affected region in the world by de-risking phenomena, since 66 percent of the banks reported a decline in CBRs. Correspondent banks have either ceased to offer their services or have restricted the type of services offered to local banks in every territory within the region.

The withdrawal of CBRs and the associated shocks to the financial system have resulted in a disruption of the payment system in the region, and this has had socio-economic consequences on the economies, including the erosion of human development, distorting competition, and inhibiting investment flows. The cost of banking services has also been negatively impacted, and it has yielded adverse effects on initiatives aimed at poverty and inequality alleviation.


Every country in the region has suffered varying degrees of loss of CBRs. In some instances, banks have had to rely on only one CBR. As a result, the Caribbean banks have had to look further afield for CBRs to settle cross-border transactions, including those with the United States of America, which is the region’s largest trading partner.

As a result, bank charges have increased, including the cost of settling payments for imports and exports to and from the region, which has, in turn, resulted in increased cost of doing business, and consequently the cost of living—all of which has negatively affected the competitiveness of the Caribbean in the global economy.

De-risking has also affected entire classes of businesses and customers. Throughout the region, correspondent banks have ceased conducting business with MSBs, bankers of MSBs, and currency exchange houses. This has had adverse effects on efforts to reduce poverty, since the region relies heavily on remittances: these flows have supported financial stability and helped to alleviate poverty. The wholesale de-risking of bankers of MSBs can also potentially lead to systemic risk in a country, since this will tend to push the accounts of MSBs to other banks that have a risk appetite for such business; hence, there would be concentration of remittance flows within few banks, and this can cause widespread de-risking of those banks.

Additionally, instances were noted where regional branches of international banks have engaged in wholesale de-risking of financial institutions that offered services to credit unions and cooperative societies, car dealers, casinos, gold traders, and those conducting third-party transactions on behalf of lawyers and other service providers.

Among some of the indirect effects of de-risking are the impacts on economic sectors, including tourism, where most of the transactions are processed via the use of credit cards, which are facilitated through correspondent banks. The inability to use credit card services has adversely affected the survival and competitiveness of the tourism sector in various jurisdictions. Also, both the financial and non-financial costs of doing business have increased; apart from the increase in bank charges, there has been an implementation of additional documentary requirements and delays in transaction processing, and it takes time to transfer funds globally.
Medium and Small-sized Enterprises (MSEs) in the Caribbean economies have traditionally relied on credit unions and local banks with sound connections to international banks. If these CBRs are not maintained, the MSEs, which have significant influence over economic activity in some territories, will lack access to the credit required for job creation.

Additionally, de-risking has also created or caused an expansion of underground/un-regulated markets, which have replaced the formal channels used to facilitate the flow of financial resources. There has been evidence in some countries in the region to suggest that the informal foreign exchange trades have begun to resurface and expand. This has been of significant concern to the international community, since it can result in global financial instability and serve as a threat to public safety and transparency in the formal sectors of the affected territories.

2.2.2 The Extent of De-risking of CBRs

Overall, the de-risking phenomena have affected various classes of business, clientele, and jurisdictions throughout the Caribbean. However, the loss of CBRs has been unevenly spread across various territories. While some countries have experienced widespread, wholesale, and sudden termination of CBRs, others have experienced the withdrawal of relationships to a lesser extent, and still others have experienced little or no loss. The impact on the Caribbean has been extensive in terms of the dollar value and is estimated at millions of United States dollars. De-risking has also had a very significant impact on doing business confidence in the region.

Notwithstanding, some of the affected institutions were able to enter into new relationships and strengthen existing relationships. Below is an analysis of the extent of the loss of CBRs on each affected territory in the region:

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Barbados

The Canadian banks operating out of Barbados were the hardest hit, due to the extremely stringent regulations of the Office of the Superintendent of Financial Institutions (OSFI), which required them to disclose information on the customers of international business corporations (IBCs) for whom the Canadian banks had maintained accounts. Eight local financial institutions have lost their CBRs, mainly with Canadian and U.S. correspondent banks, while a few of the terminations were also from banks in Germany, the Netherlands, and the United Kingdom, as well. In addition to the terminations, the IBCs have experienced restrictions on their operations, since in some instances, holds are placed on wire transfer deposits for several additional days pending the verification of recipient details. Also, some IBCs have been required to wait for several weeks beyond the required verifications period before a bank can open an account on their behalf. Some have even had their requests denied by Canadian banks unless the IBC had a direct relationship with, or is known by, the Canadian parent bank. The local banks represented that the decision to open IBC client accounts rests solely with the Canadian parent banks in Toronto, and there is generally no time frame given for opening such accounts.

Belize

In Belize, five of the seven commercial banks, including the largest systemic bank, which in aggregate accounts for 60 percent of the banking industry's total assets, have had their CBRs terminated by their U.S. correspondent banks. Also, three off-shore banks have suffered from the loss of CBRs. Only two banks, representing roughly a quarter of the banking system's assets, have managed to retain at least one CBR with full banking services. After the termination, the banks approached the Central Bank of Belize, which assisted with making foreign payments. However, the correspondent banks have objected to the practice of "nesting." In this regard, customers who were affected and unable to access their funds took their cases directly to the embassy of the United States of America.

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Cayman Islands

In the Cayman Islands, the situation is similar to that of the other territories where the U.S. correspondent banks have adopted the same risk versus reward approach, which has resulted in the banks withdrawing from funds garnered from cash-intensive business, inclusive mainly of MSBs. One U.S.-based bank has ceased specific operations in Western Union (WU) branches; due to the high risk and declining fee income, WU closed its office in the Cayman Islands during 2015.

Eastern Caribbean Currency Union (ECCU)

Correspondent banking services in the ECCU are provided mainly by banks originating from the United States of America, Canada, the United Kingdom, and Europe. The impact of the de-risking by the U.S. and Canadian banks has been mostly experienced by institutions in the IBC sector. In another instance, one bank closed its entire operations in the ECCU, an area in which its expansion drive was previously focused. Another local financial institution had also made attempts to establish a CBR for its off-shore subsidiary with a Canadian bank; however, it was told that Caribbean banks should not conduct business with MSBs and Cambios, and that Canadian banks were not establishing any new CBRs in the region.\(^\text{17}\) There was also one instance where a correspondent bank had terminated all accounts involved with a downstream correspondent or third-party intermediary activity, as well as closed the accounts of several legal professionals and local charities, and all former prime-rated customers whose business they would have previously sought to retain. Holds were also placed on the clearing of all foreign currency-denominated checks for periods ranging between six months to one year, and there were cases where the foreign currency check-clearing was denied. Additionally, a fee was also imposed by one international bank on respondents who maintained balances above USD$6 million in their correspondent bank accounts. Correspondents have also increased their charges significantly, and more stringent account-opening requirements are also being imposed on respondents.

Guyana

Guyana has experienced one of the lowest levels of terminations compared to the other territories in the region, since 44 percent of its CBR providers originated from Jamaica, Trinidad and Tobago, and Barbados. Also, the foreign-owned banks operating in Guyana did not lose any CBR. During

2011–2016, three local banks lost 50 percent or more of their CBRs. Two of the locally owned banks were unable to deposit cash or foreign currency checks, and one of the two banks has been unable to provide foreign currency drafts. This has resulted in the loss of these lines of businesses. The number of transactions conducted through the banks' CBRs declined by 52 percent, and the value of transactions declined by 27 percent. One local bank also experienced termination of 50 percent of its CBRs, moving the number of correspondent bank accounts from eight to four.

**Jamaica**

Jamaican banks have experienced both terminations and restrictions by banks in the United States, United Kingdom, and Canada. One U.S. bank, which had terminated relationships with three depository institutions, also issued restrictions on four other licensed financial services providers. The main drivers of these terminations were identified as being related to high-risk customers, including politically exposed persons (PEPs), cash-intensive businesses, and MSBs, which accounted for 46 percent of the total revenue from financial intermediation, which also generated significant foreign currency inflows for the country. The cash accounts of some of the regulated Cambios were also de-risked by local banks in Jamaica. These Cambios played a vital role in the foreign exchange market, since they provided competition to other players in the market.

Jamaican banks were also given notice by one Canadian and one U.S. bank that transactions related to MSBs and Cambios were not permitted through their accounts. The de-risking trend continued way into 2016, when correspondent banks continued to raise concerns about the cash-intensive activities associated with these entities. This, in turn, has caused local Jamaican banks to restrict the acceptance of cash from such institutions. Additionally, during 2016, one UK-based bank also terminated its international payment services with a leading building society. The reason cited for this termination was that the foreign bank no longer saw a strategic alignment of the bank's remittance services with its long-term goal.

To date, the impact of the de-risking in Jamaica has been controlled to some extent, since the banks that have been de-risked have entered into new CBRs or have utilized the banking relationships of other local banks. Mechanisms have also been implemented for the small volume Cambios, which are unable to deposit foreign currency cash with local commercial banks to sell excess foreign currency notes to larger Cambios and the private sector.
Trinidad and Tobago

The experience of the Trinidadian banks indicated that there had been efforts to avoid the risks associated with certain categories of businesses. Central Bank reports revealed that Private Members Clubs (PMCs) have been de-risked due to the large percentage of accounts in that category, which was terminated. In this regard, banks have adopted a risk-based approach to PMCs and have placed restrictions on international wire transfers from this category of customer to high-risk jurisdictions. PMCs are those entities that are registered to provide gaming and casino services and entertainment. Including video games at bars, there were more than 60 registered PMCs. Simultaneously, MSBs have been experiencing additional pressure when conducting transactions, and, as a result, have been forced to find substitute banking relationships. In response, the Trinidadian government has been working to establish a framework to address the regulatory and other concerns resulting from the de-risking of PMCs.

The Bahamas Islands

Based on surveys conducted in the Bahamas, the results revealed that at a minimum, two domestic banks and four internationally active banks representing approximately 19 percent of the assets of the banking system had been directly affected by the loss of CBRs. This appears to have resulted from AML/CFT concerns and changes in correspondent banks’ risk tolerance levels. Many financial institutions in the Bahamas have also indicated that they are subject to enhanced due diligence and monitoring by their correspondent banks. All institutions that suffered from the loss of CBRs were able to enter into new relationships. Two banks in the Bahamas have also given up their WU franchise identifying exceptionally high risks and reduction in fee income as the reason for the giving up the franchise, which they held for 20 years. Western Union has also closed its operations in the Turks and Caicos Islands for similar reasons.

Haiti

All the local banks in Haiti have also experienced loss and restrictions of CBRs.
The Caribbean region has adopted a unified approach to address the widespread loss of CBRs across the region. During 2017, and at the request of the Caribbean Community (CARICOM) Heads of Government (HOG), the Caribbean Central Bank Governors (CCBG) drafted a regional plan to address the de-risking phenomena in the Caribbean. The plan was approved by the HOG, and the Committee of Ministers of Finance (COMF) was tasked with oversight responsibility for ensuring a coordinated approach was embraced during the implementation of the plan. The plan covers six comprehensive action items as follows:

(1) **Intensify Data Collection and Analysis**

This course of action was intended to provide additional data on the scope of the problem, which could better inform proposed solutions and in turn promote high-level negotiations on the issue. It was envisaged that the data collection would be in the form of ongoing and detailed surveys of institutions within the financial sector, direct measures at the macro and institutional level on cost impact, and financial inclusion indicators. The regional central banks and financial sector regulators were identified to coordinate this action. To date, work has been done in this area, and a data collection exercise has commenced, which leveraged the expertise of the Financial Stability Board (FSB). Also, in order to avoid duplication of efforts, the work of various players, including the Committee of Payments and Market Infrastructure (CPMI), Caribbean Association of Banks (CAB), Society for Worldwide Interbank Financial Telecommunications (SWIFT), and Regional Commerce and Growth Association (RCGA) are being used to compliment current efforts.

(2) **Coordinating the Formulation of Enhanced Regulatory Guidance on the Management of Current CBR Withdrawals**

The Caribbean Group of Bank Supervisors (CGBS) has been tasked with the development and implementation of this item and was requested to provide
recommendations to be implemented at the national level in the form of documented guidelines to domestic and international banks. The guidance is intended to cover principles on structured guidance for respondents on managing relationships with correspondent banks and contingent national strategies for loss of CBRs that may have a systemic impact. In this regard, it was noted that the members of the CGBS provided the required guidance in their respective AML/CFT guidelines. However, it was agreed that the guidance could be enhanced by leveraging updated guidance issued by FATF, Bank of International Settlements (BIS), and other relevant international organizations while work is still ongoing on the development of the contingent national strategy for loss of CBRs.

(3) Capacity-Building Across the Region in AML/CFT Effectiveness

The goal of this item is to harmonize the legislative and supervisory frameworks across the region in order to achieve a greater degree of uniformity in compliance with AML/CFT standards. It was noted that the region has been conforming to the FATF and BASEL standards. In relation to uniformity in compliance, the supervisors noted that the basis for such actions would include the mutual evaluations, which are currently being carried out by Caribbean Financial Action Task Force (CFATF) and National Risk Assessments (NRAs) of AML/CFT risks, which have been embarked upon by most territories. The regional regulators have noted that these initiatives have fostered compliance with AML/CFT standards, drive legislative reforms, and further, the information-sharing agreement among members. The consolidated supervision framework are tools that promote AML/CFT convergence.

(4) Development of Recommendations on Cost-Effective Approaches to Strengthen AML/CFT System

There is a development of recommendations to strengthen the AML/CFT system of compliance in regional respondent banks, including the widespread adoption of the legal entity identifier (LEI) and similar standard to improve information captured on domestic and international payments instructions. The consensus across CGBS is that LEIs may serve to reduce some of the concerns of
correspondent banks, but it was the view that this is a longer-term measure, since it was recognized that shorter-term solutions should be pursued. Some jurisdictions held the view that LEIs and KYC registries may not eradicate the de-risking issue, because the underlying cause seems to be the volume of business, which has a cost versus return consideration for correspondent banks.

(5) Move Away From Cash-Based Domestic Transactions
There is a move away from cash-based domestic transactions in regard to correspondent bank-dependent international payments settlements. This action item requires that the CGBS establish principles for regional payment systems reform to promote the use of Fintech and e-payment solutions. A CARICOM working group has been set up in this regard, and the work of this group and other agencies, including the Caribbean Centre for Money and Finance (CCMF), will be leveraged by the CGBS.

(6) Enhance the Regional Mechanism
To remain influentially engaged in international regulatory initiatives affecting the correspondent banking landscape, enhance the regional mechanism. The regional central banks currently have representation on the FSB and RCGA of the Americas. The central banks will continue to meet and provide input on views channeled through RCGA to the FSB meetings. Participation in the forums will be used to influence international research on the impact of de-risking and to foster a more focused promulgation of international standards, which affects the behavior of correspondent banks in relation to adversely affected regional jurisdictions.

2.4 Potential Solutions to Ensure Re-risking
Correspondent banks may have a genuine cause for exiting relationships with their respondents due to high AML/CFT risk or low profitability. However, there must exist a framework to facilitate organized withdrawals of CBRs and policy interventions in order to ensure that no country is left without the service of correspondent banks, given the nexus between the provision of correspondent banking services and the economic well-being of countries. Outlined below is the
role of key players in society and short- and medium-term strategies, which should be implemented to ensure re-risking.

2.4.1 Role of the Auditor\textsuperscript{19}

The audit function, both internal and external, can play a key role in stemming the tide of de-risking. The importance of audit reviews of the AML/CFT systems of financial institutions cannot be over-emphasized, since it was mandated by FATF standards. As such, all respondents must be subject to regular independent and transparent audits by internal auditors and reliable audit firms that must attest to the effectiveness and efficiency of their AML/CFT systems of compliance. Consideration should be given to the implementation of a certification process, maybe similar to that of International Standards Organisation (ISO), which will attest to the credibility of the process adapted to demonstrate whether the respondents' AML/CFT systems are keeping with international standards. This system could lend towards increasing the level of reliance placed on respondents by correspondents, reducing the probability of termination of CBRs.

The auditor's role for AML/CFT compliance is to determine whether financial institutions have an effective, adequate, and current framework for the management of AML/CFT risk at all times. In this regard, the scope of the audit should be adequate to address the AML/CFT risk posed by the financial institution, and the auditor must also possess the requisite expertise and experience.

The auditor's review, in relation to the operations of respondent banks, must focus on:

- attesting to the overall integrity and effectiveness of the AML/CFT systems and controls of financial institutions;
- assessing the institution's risks and exposures in relation to its size, business lines, customer base, and geographic locations;
- evaluating the adequacy of the institution's internal policies and procedures to address risks identified and the effectiveness of the staff implementation of those policies and procedures;


• testing compliance with the relevant laws and regulations;
• conducting transaction testing in all areas with specific emphasis on high-risk areas, products, and services;
• evaluating employees’ knowledge of the laws, regulations, guidance, and policies and procedures;
• assessing the effectiveness of the institution’s compliance oversight and quality control, including parameters for generating automatic alerts;
• determining the adequacy, effectiveness, and completeness of training programs; and
• evaluating the adequacy of monitoring systems and the process of identifying and reporting suspicious activities.

A strong independent audit function can go a long way to enhance the AML/CFT framework of financial institutions, since it identifies deficiencies, thereby facilitating remedial action. Also, it promotes compliance with international requirements on the conduct of audits, all of which can play a significant role in the re-risking process.

2.4.2 Role of Public and Private Sectors

2.4.2.1 Role of the Public Sector

a. Ongoing Monitoring Mechanisms and Contingency Planning

The competent authorities across the Caribbean region should implement monitoring systems to ensure that data is continuously collected and analyzed on the closure of CBRs across the region, since the de-risking of CBRs continues. The monitoring should be permanent and should also be forward-looking and focus on trends in CBRs and risk assessment, which can be done through the bank supervisory/regulatory authorities, which can require regular periodic reporting on the number of CBRs terminated and maintained. The reporting should capture all entities affected by the termination of CBRs under the purview of the regulators, including all those institutions involved in the conduct of all forms of financial business and MSBs.

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Based on an analysis of data collected, the authorities should develop a contingency plan to manage and mitigate the risks associated with de-risking practices. The plan should also identify remedial measures to manage any crises and be able to prevent a systemic crisis in key sectors and provide assistance in the event that domestic banks and MSBs are faced with severe restrictions/terminations/de-risking. Supervisory authorities should also provide to stakeholders and develop and adopt a strategy to track banks in pursuit of new, stable, and low-cost CBRs, and provide support in this regard.

b. **Fostering On-going Dialogue Between Respondents and CBRs**

One important step in ensuring the maintenance of CBRs is to ensure that there is a constant dialogue between correspondents and respondents, a process that can be fostered by the supervisory authority. The lack of knowledge and understanding of a country's risk and context is one of the key factors contributing to the withdrawal of CBR. In light of this, continuous discussions should be held with international banks operating in the region. The respondents and their correspondents should be aware of each other's practices and establish personal business relationships, which are prerequisites for the maintenance of CBRs. It is envisaged that the purpose of the dialogue would make the international banks aware of actions taken by the local authorities, and the respondents will be able to understand the expectations and practices of the correspondents.

2.4.2.2 Role of the Private Sector

a. **Contingency Planning**

The management of all financial institutions should include a de-risking component in their contingency plans, since de-risking has an impact on the customers of the bank and on the bank itself. Additionally, rating agencies are considering the de-risking factor when assigning ratings to financial institutions. In view of this, CBRs should be monitored continuously, and terminations should be reported promptly to management, which should always be vigilant of its relationships with correspondent banks and include de-risking in its recovery plans. Also, the plan should guide the continuity of business in the event of sudden widespread de-risking.
2.4.2.3 Short-Term Steps

Among the critical short-term steps that should be taken are:

a. Respond in a timely and effective manner to requests for the provision of information and maintain amicable relations with correspondent banks.

b. Join KYC and SWIFT registry and other information-sharing systems in order to establish a compliance profile within the correspondent banking circle.

c. Promote transparency by making relevant, current, and accurate information easily accessible to correspondent banks and other decision-makers. Information should include, but not be limited to, data on compliance with international standards, tax transparency, and regulatory frameworks, among others.

d. Enhance sensitization efforts to inform key stakeholders of the seriousness and financial implications of de-risking and its impact on Gross Domestic Product (GDP).

e. Prepare for possible de-risking, including taking pre-emptive action where necessary.

2.4.2.4 Medium-Term Steps

These should include:

a. Launching public relations and media campaigns to clear up any misrepresentations and misperceptions on the regulatory frameworks and tax transparency of territories that are potentially vulnerable to de-risking, including performing fact checks on information that may be available on official foreign websites.

b. Explore alternative strategies, including the implementation of digital currency technology.

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c. Conduct analysis in order to estimate the contribution of high-risk sectors, including offshore and export free-trade zones' contribution to the economy.

d. Strengthen AML/CFT regimes and ensure that they are robust, since these requirements evolve over time but are not generally sufficient for maintaining CBRs and secure greater representation at standard-setting assemblies.

e. Actively participate in advisory initiatives targeting senior policy and executive levels in order to identify steps toward a more practical approach to the withdrawal of correspondent banks from jurisdictions.

2.4.2.5 Potential for the Use of Fintech

Fintech has significant capacity to lower the cost of compliance, decrease the use of cash, enhance monitoring, and promote confidence of correspondent banks. The architecture of the financial system is currently experiencing widespread changes as a result of the expansion of new technologies. Fintech is using new technologies, including distributed ledger technologies. Even though it is still in the developmental stages, Fintech appears very promising, since it offers possible solutions to de-risking that can be categorized into three areas; namely it simplifies and automates procedures, it leverages economies of scale, which were previously unavailable, and it provides alternative plans to existing correspondent banking framework.

Simplification and automation of procedure: this category is made up of KYC and transaction monitoring systems, which provide for the automation of activities previously done manually by compliance staff and include an examination of documentation, cross-referencing, and classification of suspicious transactions. Traditionally, transaction monitoring involved screening customers based on a set of defined rules. However, technology can add significant value, in that it can leverage machine learning and data algorithms in transaction monitoring. Also, machine-based learning can automatically detect patterns that correspond with suspicious activities, would have otherwise been difficult to detect by humans, and generate a suspicious activity report. Therefore, machine learning allows for more efficient allocation of resources, thereby enabling compliance staff to focus on complicated tasks. In addition, it also aids in flagging activities that would have previously been undetected. Leveraging of technology requires a synchronized

approach between financial institutions and regulatory authorities and staff who can understand and use the results obtained from the algorithms effectively.

**Automation of compliance enabling economies of scale:** this is a result of information sharing across financial institutions through KYC utilities, which are a range of information provision systems that can be used by banks to access information on customers instead of gathering the information themselves. The information is specifically relevant to correspondent banking. In this instance, financial institutions must be positive that they will not be penalized by regulators for accessing trusted KYC information from databases maintained by other parties. In addition, privacy laws may restrict the sharing, mining, and storage of information contained in KYC utilities, including details on geographic locations served and other correspondent relationships.

**Use of cryptocurrencies as bridge assets:** this approach advocates that financial institution maintain liquidity in local currency, and settlement of cross-border transactions be done with the use of the bridge assets. Various bridge assets are being proposed including Bitcoin, XRP, and Lumens. The use of cryptocurrencies to conduct cross-border transactions is dependent on institutions' ability to freely convert cryptocurrency and local currency. It has not been established whether markets affected by de-risking will be able to maintain the required number of exchanges. The level of market risk will increase due to the high volatility of the cryptocurrency exchange rates; additionally, cryptocurrency exchanges have been subjected to increasing AML/CFT requirements similar to those of financial institutions, and in some cases the requirements have even been more rigid due to the fact that in many countries, cryptocurrencies are linked to illegal funds. Therefore, efforts to use cryptocurrencies as an alternative to correspondent banking should be treated with caution, since the benefits to be derived from its use as an alternative have not been established to date.

### 3. Conclusion

There is no one-size-fits-all approach to managing risk in the financial system. Some international banks have sought to reduce their risk exposure through wholesale de-risking without considering the adverse consequences it may have on the financial system. In the words of Jennifer Shasky Calvery, former Director of the Financial Crimes Enforcement Network, and in keeping with the spirit of FATF Recommendation No. 1, which in a nutshell states: "Just because a particular
customer may be high risk does not mean that it is un-bankable and it certainly does not make an entire category of customer un-bankable. It is not the intention of the AML/CFT regulation to shut legitimate business out of the financial system, I think we can all agree that it is not possible for financial institutions to eliminate all risk. Rather the goal is to provide banking services to legitimate businesses by understanding the applicable risks and manage them appropriately.23 In essence, this should be interpreted to mean that financial institutions should focus on risk management of customers and consider the impact of de-risking decisions from all perspectives.

The Caribbean region has been one of the most significantly affected regions in the world to be impacted by the loss of CBRs, due to the perception that the region is high-risk and susceptible to financial crimes and tax evasion. Overall, de-risking has resulted in the loss of revenue to all Caribbean governments, thereby impacting negatively on their ability to meet their financial obligations. The phenomena have also resulted in the loss of jobs and increased unemployment and poverty and reduction of the region's competitiveness globally due to increasing transactions costs and a decline in its ease of doing business index.

Correspondent banks maintaining relationships in the region have identified the region's risk profile as the key driver of de-risking decisions. The key stakeholder, the regional governments, have embarked on several initiatives to counter the effects that the loss of CBRs has had on the region. Nevertheless, the region should continue to improve its AML/CFT infrastructure by developing more transparent compliance structures, balancing compliance and cost, and maximizing the use of technical tools, such as KYC utilities. LEI, among other measures, should all be engaged collectively to fight this scourge in order to positively influence the international community's perception of the region.

4. References


Untried assessment guideline.


The Economist. (December 2017). De-risking Poses a Challenge to the Caribbean.


5. Appendix: Abbreviations and Acronyms

<table>
<thead>
<tr>
<th>Abbreviations and Acronyms</th>
<th>Description</th>
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<tbody>
<tr>
<td>1. ACAMS</td>
<td>Association of Certified Anti-Money Laundering Specialists</td>
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<td>2. AML/CFT</td>
<td>Anti-Money Laundering and Countering the Financing of Terrorism</td>
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<td>4. BIS</td>
<td>Bank of International Settlement</td>
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<td>5. CAB</td>
<td>Caribbean Association of Banks</td>
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<td>6. CBR</td>
<td>Correspondent Banking Relationship</td>
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<td>7. CARICOM</td>
<td>Caribbean Community</td>
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<td>8. CCBG</td>
<td>Caribbean Central Bank Governors</td>
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<td>10. CCMF</td>
<td>Caribbean Center for Money and Finance</td>
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<td>11. CFATF</td>
<td>Caribbean Financial Action Task Force</td>
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<td>10. CGBS</td>
<td>Caribbean Group of Bank Supervisors</td>
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<td>12. COMF</td>
<td>Committee of Ministers of Finance</td>
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<td>13. CPMI</td>
<td>Committee on Payment and Market Infrastructure</td>
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<td>14. ECCU</td>
<td>Eastern Caribbean Currency Union</td>
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<td>15. FATF</td>
<td>Financial Action Task Force</td>
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<td>16. Fintech</td>
<td>Financial Technology</td>
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<td>17. FSB</td>
<td>Financial Stability Board</td>
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<td>18. FSRB</td>
<td>Financial Action Task Force Style Regional Body</td>
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<td>19. HOG</td>
<td>Heads of Government</td>
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<td>20. IBC</td>
<td>International Business Corporation</td>
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<td>21. KYC</td>
<td>Know Your Customer</td>
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<td>22. KYCC</td>
<td>Know Your Customer's Customer</td>
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<tr>
<td>23. LEI</td>
<td>Legal Entity Identifier</td>
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<td>24. MSBS</td>
<td>Money Services Businesses</td>
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<td>25. MSES</td>
<td>Micro and Small Enterprises</td>
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<tr>
<td>26. NRA</td>
<td>National Risk Assessment</td>
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<td>27. OSFI</td>
<td>Office of the Superintendent of Financial Institutions</td>
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<tr>
<td>Abbreviation</td>
<td>Description</td>
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<tr>
<td>28. PEPs</td>
<td>Politically Exposed Persons</td>
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<td>29. PMCs</td>
<td>Private Members Club</td>
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<tr>
<td>30. RCGA</td>
<td>Regional Commerce and Growth Association</td>
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<tr>
<td>31. SWIFT</td>
<td>Society for Worldwide Financial Interbank Telecommunication</td>
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<tr>
<td>32. USA</td>
<td>United States of America</td>
</tr>
<tr>
<td>33. WU</td>
<td>Western Union</td>
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