



CARIBBEAN CENTRE FOR MONEY & FINANCE

WP/01/2016

CCMF WORKING PAPER

De-Risking and its Impact: The Caribbean Perspective

**Prepared by the CARICOM Central Bank Governors
Technical Working Group on De-Risking
(Coordinator: Dr. Allan Wright, Central Bank of Barbados)**

CCMF Working Papers describe research in progress by the author(s) and are published to elicit comments and to encourage debate. The views expressed in CCMF Working Papers are those of the author(s) and do not necessarily represent the views of the CCMF.

CCMF WORKING PAPER

NUMBER 1, 2016

DE-RISKING AND ITS IMPACT: THE CARIBBEAN PERSPECTIVE

PREPARED BY THE CARICOM CENTRAL BANK GOVERNORS TECHNICAL WORKING GROUP ON
DE-RISKING (COORDINATOR: DR. ALLAN WRIGHT, CENTRAL BANK OF BARBADOS)

JUNE 2016

Published by the
Caribbean Centre for Money and Finance
The University of the West Indies, St. Augustine,
Republic of Trinidad and Tobago
Phone: (868) 645-1174, Fax: (868) 645-6017
E-Mail: ccmf@sta.uwi.edu
Website: www.ccmf-uwi.org

©Caribbean Centre for Money and Finance, 2016

All rights reserved. No part of this publication may be reproduced in any form without the permission in writing of the publishers.

Table of Contents

INTRODUCTION	3
I. BACKGROUND AND GENERAL FINDINGS.....	4
II. CARIBBEAN-WIDE IMPACT.....	6
III. WHAT MUST BE DONE?	13
REFERENCES	15

INTRODUCTION

The Caribbean Project on De-Risking involves the compilation of information to document and analyze the impact of de-risking strategies on Caribbean financial systems, and to prepare a position that will inform a Caribbean perspective on this matter. Our efforts serve to complement reports by the World Bank (WB), International Monetary Fund (IMF) and the Financial Stability Board (FSB). So far we have compiled surveyed information from the jurisdictions of Barbados, Belize, the Cayman Islands, The Bahamas, Turks and Caicos, the Eastern Caribbean Currency Union, Guyana, Haiti, Jamaica and Trinidad and Tobago and complemented this information with insights gained from discussions with local regulators, central bankers and sector specialists.

The goal of our research is to facilitate discussions among all stakeholders, including global banks, their regulators and law enforcement representatives in globally systemic countries. Our research recognizes that de-risking decisions are taken by private banks, and that their decisions are based on a complex of factors, including the cost of compliance with laws and regulations, and is an unintended consequence of decisions taken by the official sector in globally systemic countries.

Our paper includes the impact of de-risking throughout the Caribbean; this is outlined in section II, and preceding this is a background section on what exactly is correspondent banking and de-risking, along with what are the primary reasons for international banks applying a de-risking strategy within the Caribbean. Given the release of the Committee on Payments and Market Infrastructures (CPMI) Consultative Report - Correspondent Banking, October 2015 report, we briefly examine the technical measures proposed as recommendations in section III and conclude by discussing what are the next steps and the way forward.

I. BACKGROUND AND GENERAL FINDINGS

“De-risking” is an umbrella term used to describe strategies adopted by global banks to lower the overall risk exposure of their asset portfolio in response to tighter regulatory standards imposed by national and international regulatory bodies with respect to prudential risks, AML-CFT risks, tax information exchange risks, and risks of violating sanctions, as well as to protect the value of their brand. These strategies include termination of correspondent banking relationships (CBRs) with local banks (World Bank Survey, 2015; Financial Action Task Force, 2015b), as well as strategic market re-positioning, withdrawal from selected markets, closing the accounts of selected clients and classes of clients, and relocation of business (in particular to the US) to take advantage of regulatory arbitrage.

Our research shows that Caribbean banks and financial institutions have been compliant with requisite legislation and practices and all Caribbean countries are fully committed to the official international regulatory oversight processes of the Basel Committee, the FATF/CFATF anti-money laundering peer reviews and the Global Forum on the exchange of tax information. All CARICOM countries and British dependencies are also committed to the international certification process of the Financial Sector Assessment Program (FSAP) and the region has made commitments under the Foreign Account Tax Compliance Act (FATCA).

The burden of compliance with these stipulations, as well as sanctions and FATCA, is now very costly and, in the opinion of banks and many regulators, has gone well past the point where it can detect behaviour which violates the rules. Furthermore, perfect compliance is no guarantee of immunity from allegations that tarnish reputation, and is potentially costly in terms of public relations or legal costs (JPMorgan Chase, 2014; Standard Chartered, 2014; Swift, 2011). In these circumstances, our research shows that

the offer to do business with certain classes of clients and economies below a certain size carries unacceptably high risks of loss compared to the potential profits to be made.

Financial institutions, acting as correspondents, rely on the respondent bank to put sufficiently robust AML/CFT/Know Your Customer (KYC) frameworks in place to ensure that their customers are transacting legal business (Financial Action Task Force, 2014).

The peer review system of CFATF, to which all CARICOM and the British dependencies subscribe, provides certification of countries' commitment to achieve standards agreed to internationally with respect to KYC and the effectiveness of the regulatory framework. However, there is a lack of clarity about the implementation of FATF guidelines, in particular regarding whether correspondent banks are required to know their customers' customers (KYCC) (Financial Action Task Force, 2015). Also, there is no international uniformity of the sanctions regime, and the designation of 'terrorist' nations, organizations or supporters varies by country (Samuelson, 2015; Saperstein and Sant, 2015; Telavance, 2015).

For many international banks, the resulting uncertainty leads to a business decision to exit countries and/or business lines where there is no potential for profits that could match the potential fines for which they might be subject, even though the probability of such fines is low because their compliance systems are robust (Financial Action Task Force, 2015). To put the matter in strict business terms, the average unit compliance cost is now so high that it is impractical to continue to pursue certain types of business (Financial Crime Enforcement Network (FinCEN), 2015).

Based on the findings of our research, what is even more troubling is that, while all regulatory practices fully comply with FATF and Global Forum standards, and are

certified by peer reviews and FSAPs, international transactions are at risk for violating national sanctions and prohibitions in the US and elsewhere.

It is noteworthy that Canadian banks are as stringent as American banks. This may be due to the efforts of the Canadian regulator or the fact that Canadian banks are also subject to the US regulators because of their presence in the US. The US tendency is to levy the largest fines on non-American banks, such as Credit Suisse, HSBC and Standard Chartered.

II. CARIBBEAN-WIDE IMPACT

Overall the de-risking strategy impact has affected certain classes of business, clientele and jurisdictions throughout the Caribbean.

In the northern economies, Jamaica's money service businesses (cambios) have been affected as a leading local bank no longer accepts foreign instruments and remittances from some money service businesses (MSBs), while The Bahamas, the Cayman Islands and Turks and Caicos Islands have lost their cash intensive businesses (money transfers).

Belize's largest local bank, after termination, has explored the possibility of having the central bank assist with foreign payments. However the objection of 'nesting' was recently cited by the correspondent bank, resulting in customer migration. Also, all seven local banks in Haiti have experienced terminations or restrictions in service.

Within the Eastern Caribbean, including Barbados and the Eastern Caribbean Currency Union (ECCU), Canadian banks have experienced the stringent regulatory controls of the Canadian Office of Supervision of Financial Institutions (OSFI), requiring correspondent banks to know their customers' customers. The international business companies (IBCs)

have experienced the most significant impact within the Eastern Caribbean, as correspondent banks have closed entire business lines and terminated or placed onerous restrictions on accounts of former prime rated customers. The loss of businesses has been estimated in some instances in excess of several million US dollars.

The southern economies of Guyana and Trinidad and Tobago have also been impacted, with the total value of foreign correspondent transactions falling by some 27 per cent in Guyana, while in Trinidad several entities have been 'unbanked' within the past 24 months.

Within Barbados, the Canadian banks are the most affected because of the stringency of the regulations of the Canadian Office of Supervision of Financial Institutions (OSFI), which requires Canadian banks opening accounts for Barbados IBCs to submit information on the IBC's customers. One bank has closed an entire line of business in Barbados and the Caribbean and Latin America, which it previously had as a key plank for its global expansion. So far eight domestic financial institutions have had their accounts terminated primarily by Canadian and US correspondent banks, and a few banks from the Netherlands, UK and Germany also.

Several respondent banks and IBCs have had to seek alternative CBRs in other jurisdictions for some of their lost terminations; however, most of the terminations have been completely irreplaceable.

IBCs have not only experienced terminations, but also in some cases, restrictions on existing operations, including the holding for several additional days of wire transfer deposits while further verification of the recipient details is concluded.

Other IBCs have been forced to wait several weeks, beyond the normal verification period, before local banks are willing to open accounts, while others have had their

request for opening accounts refused by local Canadian banks unless the IBC business has an existing direct relationship or is known to the Canadian parent via the operation of a subsidiary. One local bank stated that decisions to open IBC client accounts are now directly dependent on Toronto, and no time frame could be generally given for the opening of accounts. A leading sector specialist commented that the inability of IBCs to open foreign denominated accounts and transact business, along with account terminations, are the greatest threat to the sector's long term viability at this time. With these developing trends, it has become very difficult to establish new business within the sector.

For Belize, the Central Bank of Belize has reported that correspondent banking relationships (CBRs) have been terminated by their US correspondents in several of the seven banks operating in the country, including the largest bank, Belize Bank. In the case of the Belize Bank, the Central Bank has offered limited assistance for the close-out of customer accounts, with these transactions being properly reported and disclosed. At the time of this report, Belize Bank is still unable to service its remaining customers, who now complain directly to the US Embassy about the inability to access their funds.

Results from a Central Bank of The Bahamas 2015 survey confirmed that the risk appetite for correspondent banking appears to have fallen. The survey data found that at least two domestic commercial banks and four international banks have been directly impacted by the loss of a correspondent banking relationship, with changes in the overall risk appetite of international financial institutions and concerns about AML/CTF risks seemingly accounting for the actions. Several financial institutions confirmed that they have been subject to heightened due diligence by their correspondent bank, while still maintaining their relationships. All institutions were able to find replacement CBRs; however, the level of difficulty or ease was commensurate with the nature of their operations and onboarding requirements.

Fidelity Bank (Bahamas) Limited and Fidelity Bank & Trust International in The Bahamas have closed their 20-year Western Union franchise in an attempt to “de-risk” their business, citing unacceptably high risks and declining compensating fees. Western Union’s operations (at its branches and sub-agent locations) closed in July 2015, with similar occurrences in the Turks and Caicos Islands.

In the Cayman Islands, there is a similar risk-reward evaluation being undertaken as US banks have withdrawn from funds sourced from cash intensive business, such as money vehicle transfer services (MVTs). Specific cases include that of Fidelity Bank that ceased facilitating Western Union’s operations at its branches and sub-agent locations. In light of reported unacceptably high risks and declining compensating fees, Western Union offices closed in July 2015. GraceKennedy Money Services has commenced operations, including the repatriation of banknotes with the support of their banker.

Correspondent relationships in the Eastern Caribbean Currency Union (ECCU) exist primarily with international banks in the United States, Canada, United Kingdom and Europe. Recent relinquishments and restrictions have been felt primarily within the IBC sector from US and Canadian banks. One correspondent bank has terminated all accounts involved with downstream correspondent or third party intermediary activity, as well as closed the accounts of several legal professionals and local charities, all former prime-rated clientele whose business they would normally seek to retain. Another bank has closed its entire operation in the Eastern Caribbean, a former focal point for its regional and global expansion. A local bank was recently told, after attempting to establish a CBR in Canada for its offshore subsidiary, that currently Canadian banks were not establishing any new banking relationships in the Caribbean and that local banks should not do business with money service businesses (MSBs) or cambios (foreign exchange trading companies).

In January 2016, the Bank of America (BOA) terminated its CBR with a commercial bank within the ECCU, citing it was no longer aligned with its current business strategy. BOA was its only correspondent bank and the commercial bank is now endeavouring to establish a new CBR with another institution.

Several local banks had to reroute some of their lost relationships with other jurisdictions and banks, usually at a higher expediency cost and with greater stringency. For local banks who have maintained relationships, there has been an onerous restriction within the past 12–24 months, as correspondent banks have increased their standard charges 10-fold in some cases and only recently another international bank imposed a fee for any balances above US\$6M. Local banks have experienced refusal to clear foreign denominated cheques, while others have been told that there will be no foreign cheque clearing for at least the next six to twelve months. There have also been increasingly stringent regulatory requirements placed on local banks, especially for the opening of new accounts.

Guyana has also been affected by de-risking. With close to half of Guyana's correspondent banking providers, approximately 44 per cent, originating from the Caribbean (Trinidad & Tobago, Barbados and Jamaica), Guyana has experienced the least terminations. Two local banks' corresponding relationships have been terminated or restricted over the past 24 months. One bank experienced terminations as well as restrictions of 50 per cent of its correspondent relationships, moving from eight accounts in 2012 to four accounts at the end of 2014. The number of transactions conducted via the bank's correspondent declined by almost 52 per cent, while the total value of such transactions fell by 27 per cent.

In Jamaica, there have been terminations and/or restrictions imposed by the banks of the USA, Canada, and the UK. One such example is of a leading US bank, which, in addition to terminating a relationship with one deposit-taking institution, issued termination

notices to two others, and has imposed restrictions on four other financial service licensees, citing strategic misalignment with regard to their risk appetite. The main drivers for these terminations have been concerns on a high risk customer base (politically exposed persons, cash intensive firms and money service businesses). Money service businesses (cambio services) accounted for 46 per cent of all sales in the financial intermediation market and generated FX inflows of US\$470M in Jamaica in 2014. The regulated non-bank foreign exchange dealers (cambios) which provided an additional layer of competition in the FX market, have lost some cash accounts with local banks. (Given the concern of the potential of de-risking expanding to larger groups, Bank of Jamaica has implemented a six-month moratorium on the surrender requirements of cambios to the central bank.)

In 2012, a Canadian and a US correspondent bank each gave Jamaican banks notice that with immediate effect, transactions for the benefit of money service businesses (MSBs/cambios) are not permitted through their accounts. Between 2014 and 2016 de-risking trends continued to rise as correspondent banks have voiced concerns about cash activity associated with the MSBs. In an effort to maintain correspondent accounts, local banks have been restricting their cash acceptance from some cambios. These developments have occurred even though Jamaica's Mutual Evaluation Reports with the FATF have been positive with regards to MSBs and have never been flagged as an AML/CFT concern nor identified as having significant weakness to supervisory or regulatory frameworks. As the principal provider of foreign currency bank note services, of considerable concern was Bank of America's notice that it will stop accepting cash emanating from cambio operations, even though Jamaica's cambio industry adheres to the same AML/CFT compliance requirements as the banking sector. Thus far the impact of de-risking has been largely contained in Jamaica. De-banked institutions have identified replacement correspondent banking relationships or have been utilizing the banking relationships of other local banks. Some small volume cambios are now unable

to deposit foreign currency cash with local commercial banks but have been able to sell excess foreign bank notes to larger cambios and to the private sector.

Also in Jamaica, Barclays Bank indicated that effective March 2016, it will be terminating its international payment services with a leading building society in Jamaica, as it no longer sees a strategic alignment of the bank's remittance services with its long term goal.

In Trinidad, banks have reported an attempt to avoid risks associated with certain categories of clients. The Central Bank of Trinidad and Tobago (CBTT) issued a statement (July 2015) indicating that private members clubs (PMCs) have effectively become "unbanked" as a large number of their accounts have been terminated over the last 24 months. Some banks have deployed a risk based approach to PMCs and have restricted international wire transfers to high risk countries. Private members' clubs account for over 60 registered entities and provide recreational gaming in casinos, video games and entertainment through bars and pubs. At the same period, there has also been increased pressure on MVTs in the conducting of FX transactions and they have been forced to seek alternative banking relationships. The Government of the Republic of Trinidad and Tobago, in keeping with AML/CFT requirements, has been working to establish a framework to address the regulatory and social concerns arising from the proliferation of PMCs.

Overall, the impact throughout the CARICOM economies and British dependencies has been extensive, affecting all classes of clients, businesses and jurisdictions. The full extent of the loss in revenue is yet to be estimated; in addition, there is an incalculable amount of new business that has been turned away and diverted to industrial countries where the information and compliance practices are less stringent.

The Committee on Payments and Market Infrastructures (CPMI, 2015) has recommended several technical measures that are aimed at alleviating some concerns and cost-related

issues to CBRs and de-risking. In the following section, we critically examine this report and provide a general feedback on the efficacy of the measures.

III. WHAT MUST BE DONE?

Global regulators and international standard setters (FATF, CPMI, OSFI, UST, etc.) need to address the complexity of regulations and risk exposures which are contributing to biases in the incentive structure against certain classes of business. In addition, there are the costs of ensuring that international transactions do not violate national sanctions and prohibitions in the USA and elsewhere.

Global regulators need to take specific steps toward a long-term solution to this urgent policy challenge.

A roundtable meeting hosted by the Central Bank of Barbados, and coordinated by the FSB, WB and IMF in December 2015, provided an enriched understanding of the complexity and multi-dimensional nature of the problem of de-risking. The forum clarified that while the Caribbean community is fully committed to the international processes of financial reforms, there are circumstances that carry the potential to threaten the stability of the financial system. It was also suggested that further scenario analysis could be undertaken on the economic impact of de-risking.

The meeting discussed ways in which further understanding of the major causes of the changes in CBRs; and the measures that could be taken by regional and international parties. The roundtable discussion welcomed the FSB's four-point plan of assessing and addressing the reduction in CBRs (FSB, 2015). The four-point plan includes a further examination of the issue, clarification of regulatory expectations, capacity-building in

jurisdictions where respondent banks are affected, and the strengthening of tools for correspondent banks to perform due diligence checks.

For respondent banks which have been affected by the termination of CBRs with international banks, some pro-active response measures may include rerouting transactions through a regional institution, diversifying currency transactions or utilizing the Federal Reserve to act as a public service, as they are reported to have offered.

REFERENCES

Caribbean Financial Action Task Force

<https://www.cfatf-gafic.org/index.php/documents/cfatf-follow-up-reports>

Cayman Islands Monetary Authority, 2014. "Cayman Islands Remittance Report by Number of Transactions, by Country & Value."

Central Bank of Belize, "Foreign Correspondent Banking Relationships." Accessed August 4, 2015.

<http://belizeinvest.net/2015/04/29/foreign-correspondent-banking-relationships/>

Central Bank of Trinidad & Tobago, Committee on Payments and Market Infrastructures. 2015 "Consultative Report- Correspondent Banking"

FATF. 2014. "Guidance for a Risk-based Approach: The Banking Sector."

<http://www.fatf-gafi.org/media/fatf/documents/reports/Risk-Based-Approach-Banking-Sector.pdf>

FATF. 2014a. "De-Risking: Global Impact and Unintended Consequences for Exclusion and Stability." Discussion paper #1.

FATF. 2015. "FATF Clarifies Risk-based Approach: Case by Case, not Wholesale De-risking." Accessed October 5, 2015

<http://www.fatf-gafi.org/publications/fatfgeneral/documents/rba-and-de-risking.html>

FATF. 2015b. "Drivers for "De-risking" Go beyond Anti-money Laundering/Terrorist Financing." Accessed September 23, 2015.

<http://www.fatf-gafi.org/documents/news/derisking-goes-beyond-amlcft.html>

Financial Stability Board. 2015. "FSB Chair Co-authors Article on Correspondent Banking and Financial Inclusion." Accessed August 10, 2015.

<http://www.financialstabilityboard.org/2015/06/fsb-chair-co-authors-article-on-correspondent-banking-and-financial-inclusion/>

Financial Stability Board. "Report to the G20 on Actions Taken to Assess and Address the Decline in Correspondent Banking" Accessed January 19, 2016

<http://www.fsb.org/wp-content/uploads/Correspondent-banking-report-to-G20-Summit.pdf>

Financial Crime Enforcement Network. U.S. Department of the Treasury "Enforcement Actions." Accessed September 2, 2015.

http://www.fincen.gov/news_room/ea/

International Monetary Fund. *Caribbean Corner*. IMF Newsletter for the Caribbean Region, September 2014. Issue 4.

JPMorgan Chase. 2014. *Annual Report 2014*. New York: JPMorgan Chase.

Samuelson, Robert J. 2015. "Great Recession Left Companies, Consumers in a State of Anxiety." Accessed August 17, 2015.

<http://www.descretnews.com>

Saperstein, Lanier and Geoffrey Sant. 2015. "Account Closed: How Bank De-risking Hurts Legitimate Customers." Accessed September 2, 2015.

<http://www.wsj.com/articles/account-closed-how-bank-de-risking-hurts-legitimate-customers-1439419093>

Standard Chartered. 2014. *Annual Report*, London: Standard Chartered.

SWIFT. 2011. "Correspondent Banking 3.0," White Paper.

http://www.swift.com/resources/documents/SWIFT_white_paper_correspondent_banking.pdf

Telavance. 2015. "Monitoring Correspondent Banking Activity- Risk, Challenges, and Typologies." Accessed September 2, 2015.

<http://www.telavance.com/advantage/previous-issues/current-issue/monitoring-correspondent-banking-activity-risks-challenges-and-typologies/>

World Bank. 2015. "Withdrawal From Correspondent Banking - Where Why and What About It -And Report on the G20 Survey on De-risking Activity in the Remittance Market."

http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2015/11/20/090224b0831efdaa/1_0/Rendered/PDF/Fact0finding0s00de0risking0surveys.pdf