Correspondent Banking – De-Risking or Managing Risk

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- What is De-Risking?
- Reasons Proffered
- Impact on Correspondent Banking & the Economy
- The Way Forward

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De-Risking: What is it?

- A global trend where financial institutions are terminating or restricting business relationships with categories of customers that are deemed high risk.
- This trend includes withdrawal of services from countries that are under geopolitical sanctions.
- “High Risk” are often non-governmental organisations, correspondent banks and money transfer businesses.

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De-Risking: Reasons Proffered

- New legislation and regulations, imposing more stringent governance and reporting requirements for AML-CFT threats:
  - 9/11 – US drive to uproot terrorism => more stringent legislation.
  - FATCA (US Patriot Act) – Further legislation and onerous requirements
  - Levin Report 2001 – Congress identifies Correspondent Banking as a gateway to money laundering into the US financial system.
  - US Banks under scrutiny by regulators – OCC, OFAC, FinCen, BSA and the Federal Reserve bank. (US Regulators)
  - Sarbanes Oxley Act of 2001;
  - Dodd-Frank Act 2010;
  - Basel III requirements
  - FDIC – Operation Choke Point 2013

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De-Risking: Reasons Proffered cont'd:

- With increased scrutiny on AML/CFT frameworks comes:
  - High penalties for non-compliance and violations e.g. **HSBC-$1.9 billion** for AML violations, **UBS- $780 million** for Tax violations, **Citi group/ Banamex USA-$140 million** for AML
  - Increasing number of sanctions regimes
  - Threats of individual prosecutions for bank executives
  - Uncertainty about how far customer due diligence should go - KYCC.

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De-Risking: Reasons Proffered cont'd:

- Correspondent Banks consider the costs of compliance outweighs the returns from certain lines of services.
- 2008 Financial Crisis – Prompted the Finance sector to rethink its definition and management of risk. Banks became more risk averse.
- Reputational Risk – Brand protection.

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Impact of De-Risking on Correspondent Banking & Economy:

- According to an IMF report presented at the 2015 High Level Caribbean Forum in St Kitts (September 4, 2015) "**More than 10 banks in at least five countries in the Caribbean (as of June 2015) including at least two central banks…….have lost important correspondent banking relationships.**"

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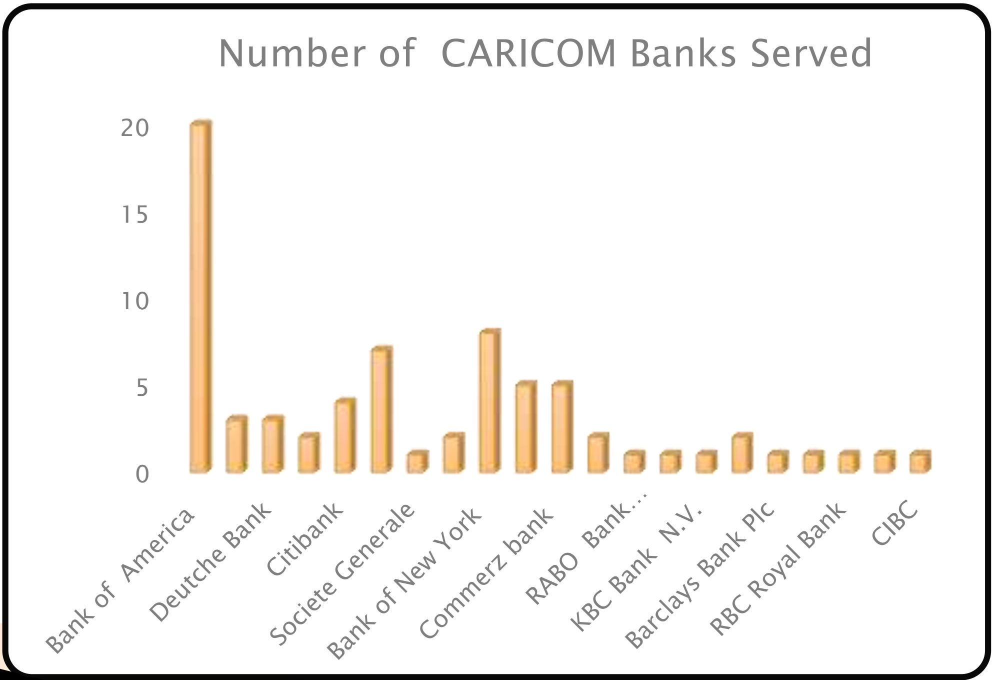
Impact of De-Risking on Correspondent Banking & Economy:

- Vulnerability arising from heavy reliance on one or two correspondent banks.
- A CAB survey of members indicates a heavy reliance on one or two US correspondent banks to provide key services such as Payment Processing, Third Party Payments & Cash Clearing.



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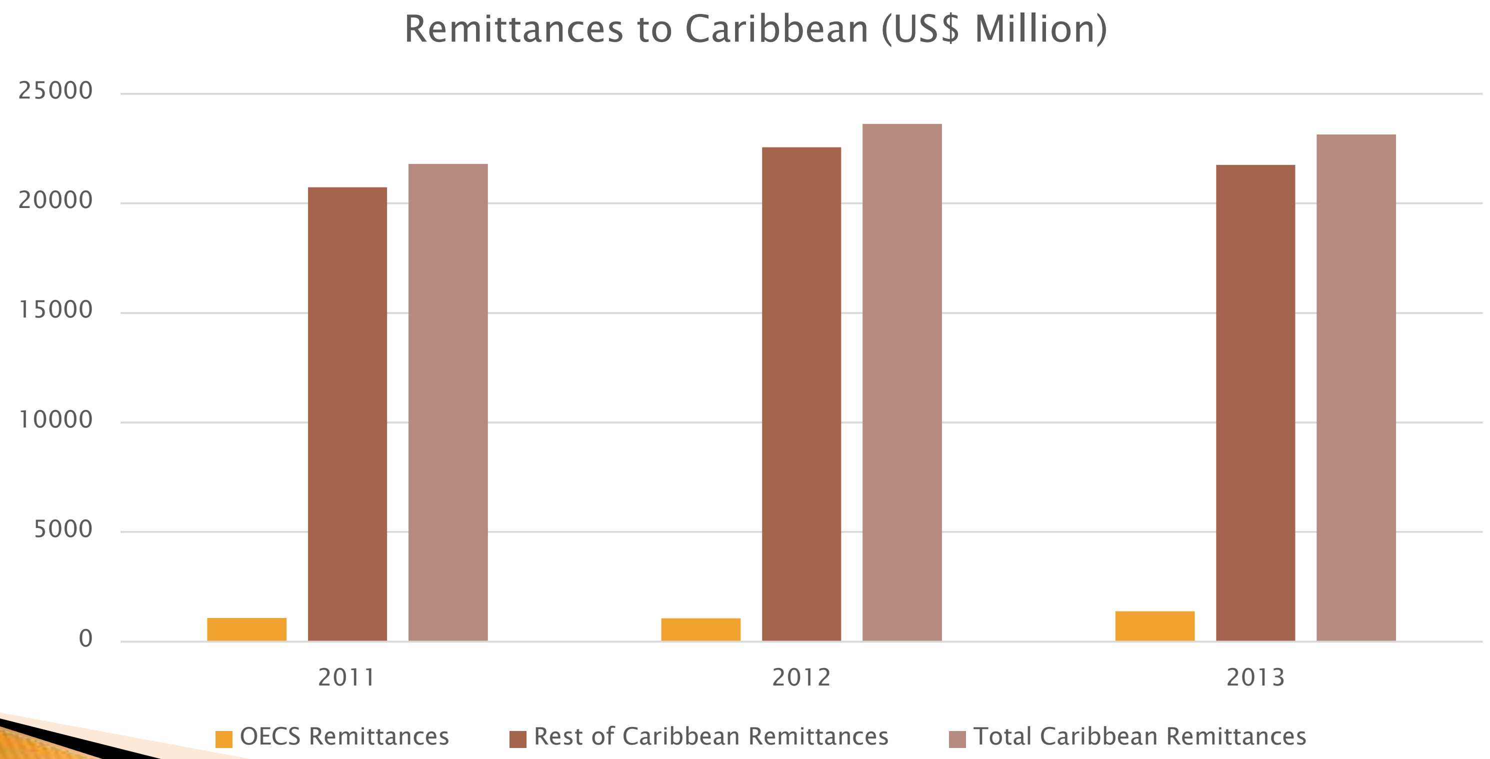
Impact of De-Risking on Correspondent Banking & Economy:

- Caribbean Region Labeled as "High Risk", negatively impacting banks and our economies e.g.
  - **March 2015 US Narcotics Control Strategy Report** – Names 7 Caribbean countries as major money laundering territories.
  - **EU "Tax Haven Black List** – 15 Caribbean counties named.
  - **US District of Columbia Budget Support Act 2015** – 17 Caribbean countries named as Tax Havens
- Despite heavy Investment to comply with national, regional and international standards (FATF/CFATF/OECD Global Forum) it would appear that this is not sufficient to avoid the negative label.

Impact of De-Risking on Correspondent Banking & Economy:

- Disruption of remittance flows affecting livelihoods of the lower income communities

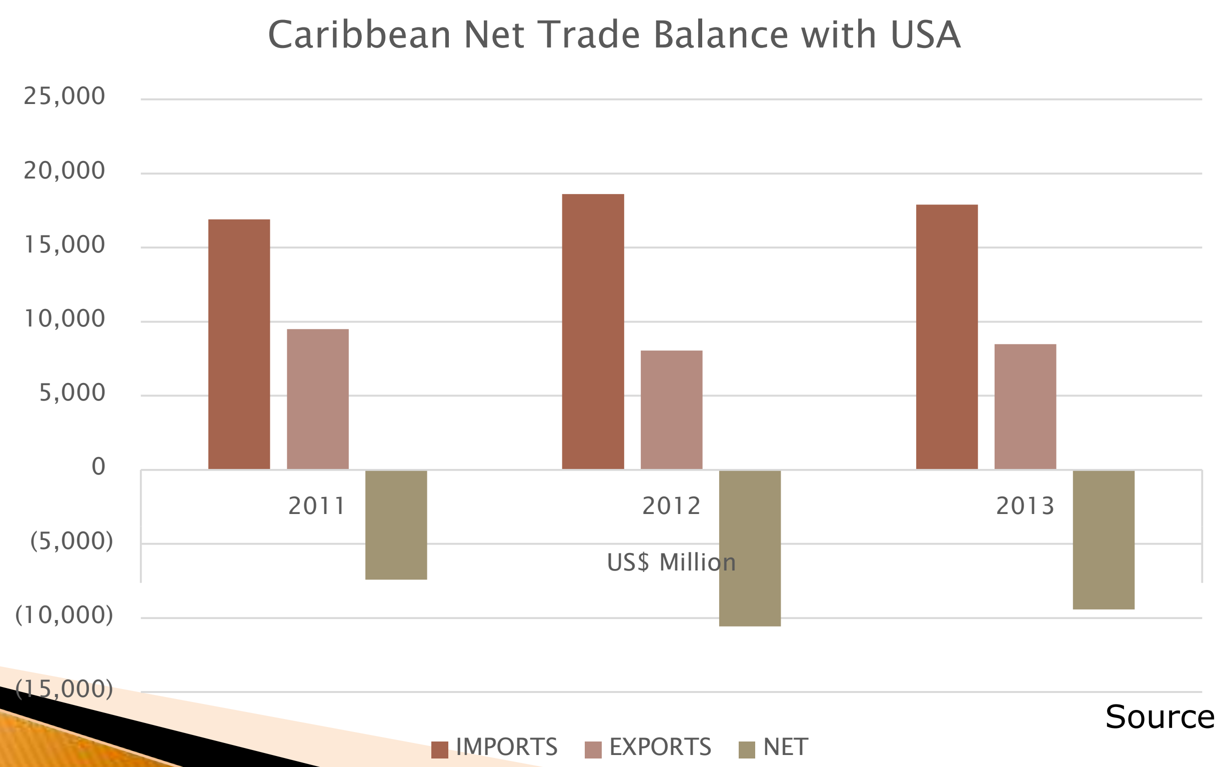


Source: World Bank

Impact of De-Risking on Correspondent Banking & Economy:

- Loss of ability to trade in goods and services will cripple the region's economies.

US Trade in Goods & Services: Import and Exports (US$ Million)



Source: CARICOM

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Impact of De-Risking on Correspondent Banking & Economy

- Shrinkage of financial sector:
  - Some indigenous banks may be forced to close
  - Meanwhile international banks are reducing their footprint in the region.
- Loss of confidence within the financial sector
- National Security – thriving underhand economy
- Increased cost of doing business
- Move business to the unregulated payment options

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Way Forward

Requires a collaborative approach: Institution, Country, Region & Correspondent Bank.

At the **Institutional Level** banks need to ensure:

- Policies and Procedures are monitored and enforced
- Independent Compliance Unit or Officer is in place
- Staff are well trained and Know Your Employee (KYE) is in place
- Invest in a risk based automated compliance monitoring system to facilitate AML/CTF compliance
- Create a culture of compliance throughout the organisation ensuring that the Board of Directors are fully involved via an Enterprise Risk Management Framework
- Ongoing client education programs
- URGENTLY address deficiencies in AML-CFT framework
- Support CAB's advocacy efforts

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Way Forward

At the **Country Level** regulators/governments need to:

- Ensure that up to date AML/CTF Legislation is in place and is continuously monitored and enforced
- Make certain that there is active representation in all relevant international forums
- Provide close monitoring of the Offshore Sector to certify that high compliance standards are maintained
- Provide sufficient compliance monitoring resources within all Central Banks and ensure that proactive measures are taken to identify and address AML/CFT deficiencies.

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Way Forward

At the **Regional** level act collectively for greater impact:

- Ensure active representation in all global forums in order to influence decisions that may impact the region
- Committee of Central Bank Governors to be more vocal and proactive on the issue
- Develop and implement a Communication Strategy to redefine the image of the region from that of "High Risk/Tax Haven" to a more positive one
- Collaborate within the region to create a harmonised regulatory system in order to reduce information gathering costs

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Way Forward

With respect to Correspondent Banks, they need to:

- Implement measures to mitigate risk rather than de-risk
- Work with their clients to enhance greater collaboration, trust and transparency.
- Provide timely communication of compliance gaps enabling the client to address issues
- Consider the position of the independent international authorities in their risk-rating assessments. The majority of Caribbean countries are in compliance with FATF & OECD Global Forum standards.

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Way Forward

Correspondent Banks contd.

Consider the serious impacts of de-risking:

- Shutting down economies, especially the most vulnerable
- Putting Key sectors such as Tourism, Manufacturing & ICT at risk
- Developing underground economies – increases AML/CFT risks
- Risk to regional security

MANAGE RISK RATHER THAN DE-RISK