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ADRIENNE ARSHT
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FINANCIAL DE-RISKING IN THE CARIBBEAN: THE US IMPLICATIONS AND WHAT NEEDS TO BE DONE

A Report by the Caribbean Initiative's Financial Inclusion Task Force

Task Force Director: Jason Marczak
Task Force Rapporteur: Wazim Mowla

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FOREWORD

The Caribbean is a destination like no other, sought out by visitors worldwide as a place of beauty, culture, and warmth. Locals welcome tourists and trading partners with open arms yet underlying that allure and charm is a persistent problem that endangers the region's tranquility: a dearth of access to the global financial system.

The ability to build businesses that support trade and tourism, to employ citizens, to facilitate economic development, and to allow families to send and receive funds from abroad is dependent on the ability to use banking services (or access them at a reasonable cost). Citizens rely on this vital connection to engage in their daily lives, highlighting the fundamental importance of financial inclusion to the Caribbean: Access concerns stretch to every island and every person in the region. Individuals, businesses, governments, and communities that have lost the ability to send money overseas or to pay for needed goods and services require the banking tools that many take for granted, the financial services that sustain their livelihoods and allow the Caribbean to thrive.

This lack of financial access in the Caribbean is significant for the United States, as well. As a region that is both geographically and historically close to the United States, the Caribbean is not only an important trading partner and a strong, reliable ally in security cooperation, but it also plays a crucial role in the history and future of the United States. The Caribbean diaspora is strong and vibrant throughout our country, including in some of the largest states like New York, Florida, Texas, and my own state of California. The United States welcomes doctors and nurses from Caribbean nations who come here in large numbers to work in hospitals, nursing homes, and the American public health system, a fact that is especially significant during this difficult, global pandemic. Companies and jobs in the US are created and sustained through the billions of annual trade dollars that our nation exchanges with the region. Our citizens, too, regularly choose the region as a first choice for respite during the cold winter months. Dwindling financial access to this important region endangers all these mutual benefits.

Because of the challenges facing our neighbors in the Caribbean and the close bond that we share, I have long been meeting with regional leaders, financial institutions, and officials in the US government to understand the causes and to examine opportunities to tackle this problem. I have brought parties together, including the correspondent banks, convening small dialogues and large roundtables, to hammer out hard issues and to explore novel and bold solutions. These discussions have proven that we, collectively, need concrete action to chip away at the decades of de-risking and deteriorating financial access.

That is why I worked with my House and Senate colleagues to pass in the 2020 National Defense Authorization Act a mandate for a US government-wide strategy to combat financial de-risking. Due this year, the US Department of the Treasury-led strategy will require our US agencies to detail the steps that they will take to address this concern and describe how Congress can support that effort. Also, in that law were provisions that, when fully implemented, will allow banks and their regulators to share information, augment the use of innovative technologies, and more accurately assess the risk of financial crimes, thus rebalancing and potentially broadening how financial services can be offered in areas like the Caribbean. Taken together, these activities are a step towards improving financial inclusion abroad, and thus, strengthening democracy, reducing poverty and inequality, and protecting U.S. interests in our shared hemisphere.

These same challenges are why the collaboration that drives the work of the Caribbean Initiative's Financial Inclusion Task Force is so significant. This report, "Financial De-risking in the Caribbean: The US Implications and What Needs to be Done," which brings public and private, US, Caribbean, and multilateral stakeholders together, carries forward the spirit to achieve better financial access and inclusion for the region. This report demonstrates the real effects of de-risking in the Caribbean and explains in detail why this issue matters for the US Government, its citizens, and its interests. Most importantly, through its collaborative format, it recommends tangible actions, such as a multilateral banking forum and a regional mechanism to increase transaction volumes, to remedy this long-standing issue.

It is by working together like this that the United States and the Caribbean can best withstand and tackle any economic or security challenges ahead. I look forward to engaging with the Caribbean Initiative's Financial Inclusion Task Force and its members to continue the efforts to repair the region's connection to global finance. Together, we can protect, revitalize, and support the economic opportunities for an entire generation.

Chairwoman Maxine Waters
House Financial Services Committee

EXECUTIVE SUMMARY

Access to the global financial system and development tools is critical for Caribbean economic recovery, growth, and resilience. This access depends on correspondent banking—a medium that governments and financial institutions use to facilitate trade, investments, remittances, foreign aid, and more. But, over the past several years, most Caribbean governments and banks have seen a steady decline in correspondent banking relationships. Institutions across the world increasingly deem the region too small to be profitable due to high compliance costs, while maintaining a perception that the region is a high-risk jurisdiction.

The withdrawal of correspondent banking relations, otherwise known as de-risking, means that valued Caribbean economic sectors—such as tourism, trade, remittances, and potential foreign direct investment—are becoming handicapped. The result is stagnated economic growth and inclusion, as the sectors hardest hit by de-risking, like tourism and remittances, are vital to the livelihoods of Caribbean people. But, de-risking affects more than just the Caribbean. It can help to accelerate increased poverty, reduced purchasing power, the growing use of Chinese currencies, and the potential for regional instability, with direct implications for the United States.

This report—the result of a nearly yearlong series of deliberations with the Financial Inclusion Task Force of the Adrienne Arsht Latin America Center's Caribbean Initiative—identifies how the withdrawal of correspondent banking relations affects Caribbean economies and people, as well as US-Caribbean relations. Based on task force findings, it then outlines policy recommendations that can strengthen financial inclusion and access across the region. The report represents diverse views, as the task force includes representatives from correspondent and respondent bankers, regulators, and members of multilateral institutions from across the United States and the Caribbean.

Task force recommendations are centered on four key themes: a regional approach to improving the profitability of correspondent banking in the Caribbean; the importance of setting consistent standards for international compliance; why correspondent banking is critical to the global financial system; and how to build relationships between US and Caribbean banks. The recommendations are briefly outlined below.

1. International financial institutions should work with Caribbean governments and their central banks to create a regional grouping or mechanism that pools transactions to a size that is profitable for bigger correspondent banks.

2. The US Department of Treasury should work to install a mechanism that standardizes compliance requirements annually, facilitates technical trainings that help Caribbean respondent banks meet these requirements, and brings in a third party, autonomous institution to evaluate Caribbean respondent banks' progress in meeting the predetermined standards.[1]3 The United States Department of Treasury, members of the US Congress, and international financial institutions should consider identifying correspondent banking as critical market infrastructure.

3. The United States Department of Treasury, members of the US Congress, and international financial institutions should consider identifying correspondent banking as critical market infrastructure.

4. The US Department of Treasury, Caribbean governments, and international financial institutions should consider hosting an annual hybrid-banking forum that brings smaller jurisdictions and correspondent banks together to facilitate relationship building and strengthening.

INTRODUCTION

Financial inclusion is vital for the Caribbean, its immediate neighbors, the Western Hemisphere, and the broader global financial system. While Caribbean Community (CARICOM) economies, populations, and transaction values are small, CARICOM's markets and geographic location make it a prime region for shipping, offshore finance, and trade. The region is diverse. The Bahamas is off the coast of Florida, Belize in Central America, and Guyana in South America, meaning that the outward effects of Caribbean challenges touch different corners of the hemisphere. With a globalized system that continues to intertwine governments and regional institutions, the financial health of the Caribbean is growing in importance for the world. A prosperous Caribbean is important for the United States and the broader Latin America region to benefit from stability for key transit points for trade and shipping. As a region that holds fourteen votes in multilateral institutions, the region is critical to advancing key resolutions in these groupings.

But, for the Caribbean to maintain a healthy presence for itself and the wider world, it needs to overcome challenges to financial development, access, and inclusion. The Caribbean is already facing severe challenges due to the COVID-19 pandemic and climate change. And, as the region looks to combat them and accelerate recovery and resilience, it needs access to the global financial system and the benefits that come with it. Caribbean countries lag behind many peer countries globally in terms of financial development, owing to their histories of volatile economic performance, vulnerabilities to external shocks, and issues related to their size and levels of development. These and related challenges have acted as breaks on inclusive growth and development.

While the region needs to accelerate its economic recovery and build resilience to current and forthcoming challenges, access to critical and requisite development tools is falling out of reach. Correspondent banking relations (CBRs) are essential to economic recovery, as these banking services are the medium that governments, financial institutions, and citizens use to process transactions and access global markets and international currencies, such as the US dollar.

Since 2015, Caribbean governments, banks, and local institutions are seeing a decline of CBRs, with the World Bank citing the region as the most severely affected by this phenomenon from a global perspective.[2] A 2017 survey by the Caribbean Association of Banks (CAB) highlighted that twenty-one of twenty-three Caribbean countries lost at least one CBR.[3] As well, a Caribbean Financial Action Task Force (CFATF) survey in 2019 showed that at least sixteen banks from The Bahamas, Belize, Jamaica, and members of the Organization of Eastern Caribbean States (OECS) lost access to CBRs.[4] The loss of CBRs is having top-down implications, affecting more than just central banks, including micro, small, and medium-sized enterprises (MSMEs) and the overall working-class populations.

The loss of CBRs is having top-down implications, affecting more than just central banks, including micro, small, and medium-sized enterprises (MSMEs) and the overall working-class populations.

Exclusion from global finance through the withdrawal of CBRs has worrisome implications for the Caribbean. The broader importance of tourism means that economies are heavily reliant on access to hard currencies and the use of credit cards to process transactions from visitors. Loss of CBRs limits this ability for governments and hotels. CBRs are also integral to remittance flows to the Caribbean. Rising costs of transactions, due to costly regulatory requirements and fines, have put remittances to working-class populations in the region at risk, potentially inducing loss of livelihoods. CBRs are also needed for international trade and finance. Limited access to trade finance stunts development and economic growth for a region already struggling to recover during the pandemic.

But, the effects of de-risking in the Caribbean have implications beyond its borders. Due to the many existing interlinkages with the Caribbean, the United States and the broader hemisphere are also impacted. Many products and services imported to the Caribbean come from the United States, Europe, and some Latin American countries. Loss of remittances and limited access to trade finance would decreases the purchasing power of Caribbean businesses and their ability to import goods.

Amid the loss of CBRs and the critical functions they facilitate, conditions conducive to instability and shadow banking rise. Instability can be a push factor for migration across the hemisphere, including to US borders, and shadow banking can fuel illicit activities for transnational criminal organizations. Further, loss of CBRs is occurring as Chinese CBRs globally are rising. This has led to an increase in Chinese-Caribbean cooperation, particularly a gradual, increased use of Chinese renminbi (RMB) as regional governments struggle to access the US dollar.

CORRESPONDENT BANKING AND ITS DECLINE IN THE CARIBBEAN

Financial development and access to finance are cornerstones of economic growth and development. Critical to this growth and development are correspondent banking and cross-border financial flows, without which countries, financial institutions, and both individuals and corporate entities that use them would not be able to transact or effect payments. These payments are necessary for international and domestic trade, investment, portfolio management, and other key cross-border transactions like transfers and remittances.

Correspondent banking is a process in which a financial institution (a respondent bank) acts on behalf of a local client (an individual or entity) by initiating a cross-border transfer of funds or some other transaction with a different institution located abroad (the correspondent bank). Historically, many important correspondent banks have been larger institutions with a presence in numerous jurisdictions that work with smaller local banks. These smaller banks have tended to rely on such relationships for access to foreign markets and currencies.

Over the past decade, many financial institutions that previously provided international correspondent banking services have reduced the number and volume of related transactions and relationships. This process withdrawal has commonly become known as “de-risking.” Drivers of de-risking include concerns from internationally active regulated financial institutions about the business rationale for such transactions (e.g., costs vs. benefits). These concerns occur against the backdrop of rising operational and financial risks linked to these transactions, due to increasing regulatory scrutiny and requirements from international bodies and governments like that of the United States. This includes the risks of fines or sanctions that might be imposed if banks are found to have deficient compliance, and/or the growing costs associated with meeting such requirements.

The following section uses newly available data to highlight how the landscape for correspondent banking and global trade and payments has evolved over the past decade. This analysis specifically focuses on the latest available Society for Worldwide Interbank Financial Telecommunication (SWIFT) transaction data, covering two hundred and twenty jurisdictions.

Because financial institutions have multiple means to exchange information about their financial transactions, SWIFT statistics on financial flows do not represent complete market or industry statistics. That said, SWIFT data are generally considered to represent the best and most comprehensive source for global interbank and cross-border transactions data (see Box 1).

Box 1. SWIFT Payments System: A Critical Financial Market Infrastructure

SWIFT is a Belgian cooperative society that serves as an intermediary and executor of financial transactions between banks worldwide. It also sells software and services to financial institutions. SWIFT does not facilitate funds transfer; rather, it sends payment orders, which must be settled by correspondent accounts that the institutions have with each other. To exchange banking transactions, each financial institution must have a banking relationship by either being legally organized as a bank or through its affiliation with at least one bank. As of 2018, more than half of all high-value cross-border payments worldwide used the SWIFT network. In 2015, SWIFT linked more than eleven thousand financial institutions in more than two hundred countries and territories, which were exchanging an average of more than thirty-two million messages per day (compared to an average of 2.4 million daily messages in 1995). Given its importance to the global financial system, the SWIFT network and the transactions that it facilitates are considered by regulators to constitute a critical market financial infrastructure (CFMI). CFMIs have been singled out by global regulators and central banks because financial systems, institutions, and economies that rely upon them would find it difficult—and, in some cases, impossible—to continue functioning if they were somehow impaired or ceased functioning.

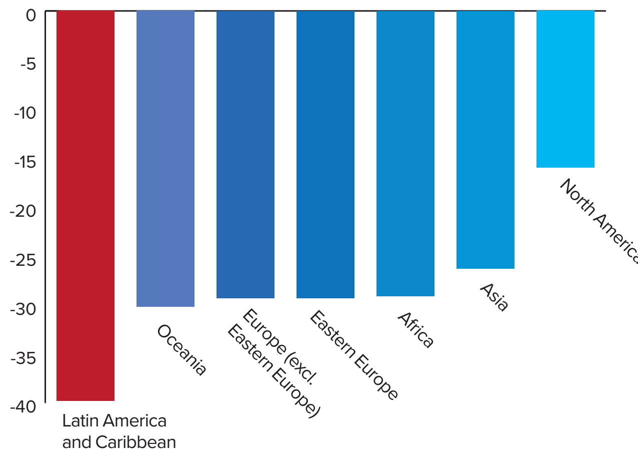
Evolution of Correspondent Banking Relationships 2011–2020 (SWIFT transactions)

Available SWIFT data suggest that two key indicators (the number of correspondent corridors and active correspondents) have declined over the past decade. An active corridor is a country pair (e.g., the United States and Jamaica) that processed at least one transaction. Correspondent relationships measure the number of banks that have sent or received messages. As a result, correspondents present in more than one corridor may be counted several times. From 2011–2020, SWIFT data show a steady and significant decline over the past decade in both the number of corridors and correspondents. In 2011, active correspondents and corridors stood at 127,254 and 10,818, respectively. By 2020, both decreased to 96,511 and 9,318, with Caribbean institutions among the most severely affected.

Evolution of Correspondents by Region: Latin America and the Caribbean Suffered Most

Some countries and regions have seen more significant withdrawals than others. Among the regions that have been especially affected are the Caribbean, the Pacific Islands, the Middle East and North Africa, Central Asia, and sub-Saharan Africa. From 2011 to 2020, Latin America and the Caribbean saw the most significant reduction in active correspondents—a contraction of about 40 percent (see Figure 2).

FIGURE 2. Change in the Number of Active Correspondents by Region (2011–2020, percent)

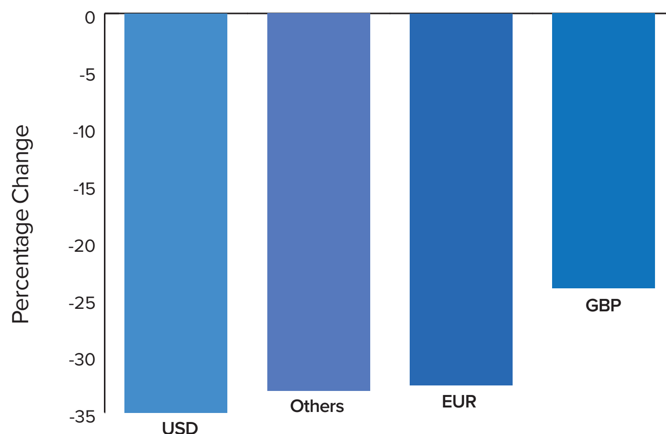


Sources: Henry Mooney, based on data from the Bank of International Settlements (BIS), SWIFT Business Intelligence (BI) Watch, and the National Bank of Belgium.
Notes: Change from January 1, 2011 through January 1, 2020.

Transactions by Currency: US Dollar Leads Declines

In terms of currencies, US dollar transactions represented about 49 percent of the total value of transfers in SWIFT messages in 2020, followed by the euro and British pound. Other currencies represented about 18 percent of the total. Despite the dollar being the most significant currency in terms of transactions in aggregate, dollar-denominated transactions contracted the most in terms of active correspondents—by about 35 percent (see Figure 3).

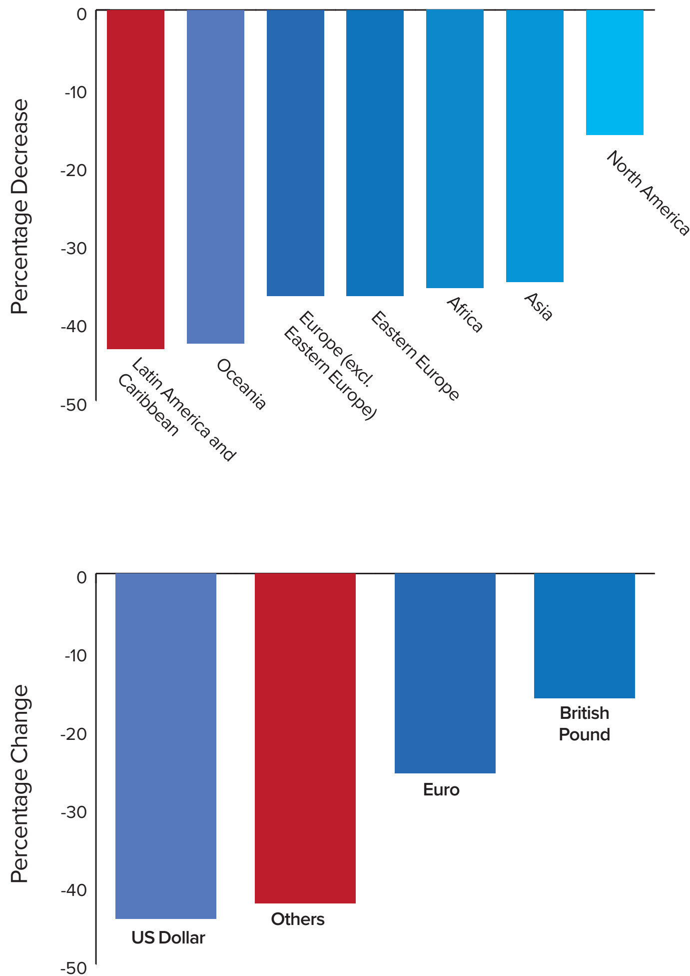
FIGURE 3. Transactions by Currency and Change in Active Correspondents by Currency (2011–2020, percent)



Sources: Henry Mooney, based on data from BIS, SWIFT BI Watch, and the National Bank of Belgium.
Notes: Change from January 1, 2011 through January 1, 2020.

By region, the largest contraction in active US dollar CBRs was for Latin America and the Caribbean (LAC)—by about 43 percent—followed by Oceania and Europe. The Caribbean was among the hardest hit regions in terms of US-dollar (USD) correspondents, with a contraction of about 42 percent overall from 2011 to 2020 (see Figure 4).

FIGURE 4. **Change in the Number of Active USD Correspondents by Sub-Region (2011–2020, percent)**



Sources: Henry Mooney, based on data from BIS, SWIFT BI Watch, and the National Bank of Belgium.
Notes: Change from January 1, 2011 through January 1, 2020.

FIGURE 5. Changes in Correspondent Banking Relationships (2011–2020) in the Caribbean Counterparties, Transaction Volume, and Value (percent and rank vs. two hundred and twenty jurisdictions globally)

14 Americas Jurisdictions (of 220 total globally	CBR Counterparties		Transaction Volume		Transaction Value	
	Change (%)	Global Rank (/220)	Change (%)	Global Rank (/220)	Change (%)	Global Rank (/220)
Belize	-50.8	30	-56.2	18	-43.2	22
St. Vincent and the Grenadines	-44.8	47	-5.2	15	-46.9	81
Dominica	-41.6	56	-55.3	49	-8.5	23
The Bahamas	-41.3	62	-27.8	103	25.4	54
Jamaica	-40.0	65	20.7	200	91.9	111
Trinidad and Tobago	-39.1	69	22.9	151	46.0	118
Suriname	-36.4	82	-10.1	65	3.0	73
St. Kitts and Nevis	-36.0	85	66.3	69	5.5	160
Grenada	-33.3	100	125.2	121	30.5	189
Barbados	-33.0	102	-28.3	79	13.4	53
St. Lucia	-31.5	111	-1.7	70	7.4	83
Antigua	-30.2	118	5.7	85	16.7	94
Haiti	-27.5	129	38.1	166	51.8	139
Guyana	-20.5	171	28.7	184	66.9	129

Sources: Henry Mooney' calculations, based on data from BIS, SWIFT BI Watch, and the National Bank of Belgium.
Notes: Change from January 1, 2011 through January 1, 2020.

Changes in CBRs, Transaction Volumes, and Values (2011–2020)

As highlighted in Figure 5, SWIFT transactions and messages from 2011–2020 show that of the forty-seven jurisdictions located in Latin America and the Caribbean, forty-six saw a reduction in CBR counterparties. This ranged from a 76-percent reduction for Venezuela to an increase of about 47 percent for Monserrat (the only jurisdiction with an increase over the period).

However, the story is more nuanced in terms of other crucial measures of correspondent banking, particularly transaction volumes and values. For example, Belize saw a reduction of about 56 percent in transaction volumes and 43 percent in values, while Saint Vincent and the Grenadines and Dominica also saw transaction values decline. However, Jamaica saw both volumes and values increase, despite a considerable decline in CBR relationships over the same period. The decline of CBRs, despite increases in volumes and values, creates a greater concentration of risk for the remaining relationships. The picture is mixed for most other Caribbean countries, suggesting that while the process of counterparty withdrawal has been broad based, this phenomenon has not reduced transaction volumes and/or values across the board in the SWIFT platform. An important question—one with an answer impossible to determine from the data analyzed—is whether transaction volumes and values might have increased by an even greater margin had such large proportions of transaction volumes not been lost?

MAIN DRIVERS OF DE-RISKING

Two main drivers of de-risking are rising compliance costs and declining risk tolerance. Countries with the steepest declines in correspondent banking activity are ones that offer an unattractive ratio between the benefits from being present in these markets and the costs associated with due diligence. Adding to the cost for due diligence is the perceived or real risk stemming from reputational or financial costs related to regulatory challenges, including fines for non-compliance, some of which have been substantial. As a result, declines have been biggest in countries perceived as being at high risk of money laundering, terrorist financing, or evasion of sanctions, adding to overall reputational risk. Countries with large offshore banking sectors have experienced significant declines as well.

The Caribbean faces an additional problem. Correspondent banking is typically a fee-based service, and small Caribbean countries may not be able to generate a sufficient volume of payments to cover the costs of servicing them, especially when compliance costs are rising.[5] In addition, there are important fixed costs for understanding the regulatory framework and enforcement in a country, which puts smaller, lesser-known countries at a disadvantage.

Correspondent banking is typically a fee-based service, and small Caribbean countries may not be able to generate a sufficient volume of payments to cover the costs of servicing them, especially when compliance costs are rising.

Cost of compliance with AML/CFT standards

In a 2017 survey, the Financial Stability Board (FSB) found that 20 percent of CBR terminations were a result of anti-money laundering and combatting financing of terrorism (AML/CFT) sanctions.[6] Issues included rising compliance costs as well as a lack of confidence in the respondent banks' risk controls. National governments assign financial institutions significant responsibilities to counter illicit finance. These responsibilities include performing due diligence on customers, monitoring accounts and transactions for suspicious activity, and reporting suspicious activities to the government.

A report by the Center for Global Development noted that regulators in the United States, United Kingdom, and several other countries have raised their AML/CFT compliance standards, and simultaneously targeted financial institutions that fell short of these standards.[7] As a result, banks have tried to scale up their existing compliance procedures or enact new ones.[8] Despite these efforts, AML/CFT costs are rising. For instance, KPMG's 2014 annual anti-money laundering survey reported that 78 percent of respondents had increased spending on anti-money laundering compliance since 2011, with a fifth of respondents claiming spending increases of more than 50 percent.[9]

For some banks, compliance costs have risen so much that the provision of correspondent banking services is no longer profitable for them, and there "is no business justification for continuing to engage in correspondent banking."[10] The cost argument is a bigger challenge for smaller countries in the Caribbean with many characteristics that make correspondent banking less attractive.

Reputational Risk Due to Drug Trafficking and Money Laundering

Caribbean countries have several of the attributes described above, which contribute to increased or consistent reputational risk. Reports of money laundering or drug trafficking often make media headlines, which increases the assumption that the Caribbean is a high-risk region and can decrease the public's confidence in regional financial institutions.

Each year, this is characterized by the US Department of State's International Narcotics Control Strategy (INCS) report on drug and chemical control and money laundering. Each report highlights countries that are either major drug-transit countries and/or major money-laundering jurisdictions. In 2021, thirteen CARICOM countries were classified as major money-laundering jurisdictions (Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Guyana, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, and Trinidad and Tobago), with The Bahamas, Belize, Haiti, and Jamaica also considered major drug-transit countries.[11]

Crime is an important concern for several Caribbean countries and, given their location between South America and the United States, drug-related criminal activity remains a significant problem. For instance, the INCS report notes that Jamaican gangs export marijuana across the Caribbean in exchange for illicit firearms.[12] The guns-for-drugs trade between Jamaica and Haiti, and the resulting media headlines, further amplifies the perception of Jamaica as a high-risk jurisdiction.[13] As well, for The Bahamas, its classification as a drug-transit country is increasingly detrimental to its reputation, due to its proximity to Florida's coast.

THE EFFECTS OF DE-RISKING ON KEY CARIBBEAN ECONOMIC SECTORS

Remittances

Remittance flows to the Caribbean are critical for supplementing incomes of working-class populations and accessing the US dollar. As of 2020, countries such as Jamaica (22.2 percent of gross domestic product (GDP)) and Haiti (21.4 percent) register remittances as more than one fifth of their GDP.[14] Others (Belize, Guyana, Dominica, Saint Vincent and the Grenadines) see remittances contribute upward of 5 percent of GDP.[15] For these countries, remittances were critical to helping Caribbean citizens maintain livelihoods during the pandemic. Remittances replaced lost incomes, maintained purchasing power for goods and medical services, and reduced burdens on governments struggling to support citizens. This was seen in Jamaica. Many citizens were able to stay afloat because remittance flows to the island were on par with pre-pandemic levels.

CBRs allow remittance companies, such as money-transfer operators (MTOs), to facilitate moving currency from one financial institution to another. MTOs are essential for the Caribbean, as they help process remittance transactions and convert internationalized currencies (such as the US dollar) to localized currencies. De-risking has caused challenges for MTOs through account closures by correspondent banks, leaving these companies and the people dependent on them without access to needed internationalized currency.

For the MTOs, de-risking or the potential loss of CBRs have increased their operational costs and restricted customer bases. For average citizens in sending and receiving countries, the amount of money that can be transferred is capped at small amounts, which increases the number of transactions. Because the costs of transactions are increasing for MTOs and correspondent banks due to high perceptions of risk in the Caribbean, the cost of transactions to send remittances is also increasing. Rising cost is, therefore, a deterrent to both MTOs and people sending and receiving remittances. The result has broader implications as well. Smaller operations lose the ability to compete with larger MTOs as oversight and regulatory compliance become more expensive. Further, the potential loss of CBRs incentivizes more use of cash and informal means of transferring money. This indirectly limits correspondent banks and other regulatory bodies in their ability to monitor remittance flows, creating less transparency.

Access to the Global Financial System (Trade, Foreign Direct Investment, and Access to Credit)

Caribbean economies are small, open economies that are more reliant than those of most nations on international commerce, trade, and financial flows. Most of these economies also run large and persistent physical-trade deficits with the rest of the world, as they rely on imported foods, fuel, and capital goods not available or produced domestically. This generally requires economies to be net importers of capital (in the form of investment, credit, or remittances from abroad) to finance this trade imbalance. Similarly, as developing countries, these Caribbean countries also rely on foreign financing to support key growth sectors, and to finance public investment. In all these and many other contexts, Caribbean countries require access to international capital markets, and unencumbered flows of finance from abroad. Correspondent banking relationships are key to this process.

De-risking has caused challenges for MTOs through account closures by correspondent banks, leaving these companies and the people dependent on them without access to needed internationalized currency.

Without correspondent banks, many of these transactions, investments, and transfers would not be possible, especially as Caribbean countries look to accelerate economic recovery during the pandemic. Continued de-risking can result in higher costs for many critical transactions that can change the cost-benefit calculus and compromise market functioning. At the extreme, de-risking and the loss of CBRs could have devastating implications for already-fragile Caribbean economies. As highlighted in Table 1, the last decade has seen transaction volumes and values contract in some Caribbean economies, which has been linked with slower growth and other adverse impacts on economic activity. Loss of CBRs can restrict banking customers from sending or receiving foreign payments or maintaining relationships with foreign suppliers, resulting in potential lost revenues for MSMEs. Limited revenue can lead to these businesses defaulting on banking loans, which, in turn, weakens the domestic banking system.

The loss of correspondent banking relations has adverse effects on the tourism sector, which has already been hard hit during the COVID-19 pandemic. July 17, 2021 (REUTERS/Andrea De Silva).

Tourism Industry

The Caribbean's proximity to the United States and its geographic landscapes make the region's islands ideal tourist destinations. The tourism sector affects more than hotels and ports, creating additional benefits for local restaurants, supermarkets, and shops. The result is that most Caribbean economies are heavily dependent on tourism. According to the Inter-American Development Bank's Tourism Dependency Index (TDI)—which measures tourism's contributions to export receipts, GDP, and employment—ten CARICOM members sit in the top twenty most tourism-dependent economies globally.[16] For countries such as Jamaica, where both tourism and remittances are critical to economic stability, these two sectors account for more than half of the island's total GDP.

As is the case for most key Caribbean economic sectors, correspondent banking is critical to the tourism economy. Correspondent banking is essential for credit-card settlements. The inability to process transactions via credit or debit cards due to lost CBRs or high costs in accessing the US dollar can deter tourists from buying goods from local shops and businesses. Similarly, de-risking means that local hoteliers and restaurants that provide food and accommodations for guests—such as pillows and bedsheets, among others—are challenged to purchase these products from foreign sources. The result can have a ripple effect on the entire tourism industry. And, because most CARICOM members depend on tourism for economic stability and growth, and as a source of employment, de-risking has the potential to induce broader instability through job loss and restricted incomes.

DE-RISKING AND ITS IMPACT ON US-CARIBBEAN RELATIONS

As the Caribbean's closest partner in terms of proximity, trade, and strategic interests, de-risking has implications for the United States as well. The Caribbean is the fifth-largest trading partner for the United States. Regional businesses source products, goods, and services from the United States, and this is best seen in trade between Florida and Latin America and the Caribbean. Florida accounts for about 30 percent of total US trade with Latin America and the Caribbean, with the Caribbean accounting for nearly 40 percent of Florida's trade with the overall region. As de-risking indirectly contributes to job loss, restricted revenue (particularly in the tourism sector), and broader economic stability, consumers and businesses lose the purchasing power necessary to keep US-Caribbean trade afloat.[17]

Growing Caribbean-China Cooperation

The continued loss of CBRs from US banks presents an opportunity for Caribbean governments and financial institutions to seek new or strengthen existing relationships abroad, notably with China. While Caribbean governments and people rely on the US dollar, it is not the only internationalized currency. The euro is an alternative, but Caribbean governments face similar de-risking challenges with banks in the European Union. The result is an opportunity for China's currency (RMB) and its banks to strengthen Caribbean ties. Currently, Chinese RMB is not internationally traded to the extent of the US dollar or the euro, nor are Chinese banks as present as US correspondent banks, but their use is increasing globally. From 2009 to 2016, Chinese CBRs globally grew from sixty-five to 2,246. More banking relations offer China new avenues to engage with partners in developing regions that are currently struggling to attract or maintain CBRs, such as Caribbean countries.[18]

Beyond growing Chinese CBRs, the RMB has been welcomed in the region. In 2015, Suriname and China signed a Bilateral Swap Agreement (BSA). This cross-currency swap provides Suriname the right to exchange currency with China at a fixed interest rate. The result has been that hundred-renminbi notes have become regularized in Suriname.

The BSA had an impact on financial services as well.[19] China UnionPay, the Southern Commercial Bank, and De Surinaamsche Bank cooperated to create Surinamese UnionPay prepaid cards. When announced, the then Chinese ambassador to Suriname Yang Zigang highlighted the crucial benefits of UnionPay—more Chinese banks, enterprises, and tourists coming to the country. For China and Suriname, this was a win. For China, it created a new avenue into the Caribbean and South America, especially given Suriname's current and potential natural resources. For Suriname, it gained a stronger relationship with a country willing to bring economic benefits and exposure to new markets for local businesses.

The draw of new banks, enterprises, and tourists through new banking relations and RMB usage is attractive for most Caribbean countries. Most CARICOM members are tourism-dependent economies, and require heavy public-private investment to aid their development goals. Caribbean countries, due to their unique vulnerabilities and limited economic and political clout, have focused on being pragmatic actors. Decisions made by Caribbean leaders rely on what is best for growth, sustainable development, and their citizens. Therefore, while Caribbean countries work with partners in the Western Hemisphere, they also engage with others, such as China. In this case, China actively sees the strategic importance of the Caribbean as a venue for new banking relations and investment—and, of course, a region that houses five Taiwan allies (Haiti, Belize, Saint Kitts and Nevis, Saint Lucia, and Saint Vincent and the Grenadines).

Lost access to the US dollar opens up new possibilities for Caribbean governments to normalize usage of Chinese RMB., February 14, 2022 (REUTERS/Dado Ruvic/Illustration).

For US-Caribbean relations, several implications exist for the growing ties with China.

1. **The growing availability of Chinese currency is an alternative to the US dollar.** The more it is regularized, and the more bankers become knowledgeable about RMB, the more they are likely to incorporate it into their portfolios.

2. **Continued loss of US CBRs is an opportunity for Chinese banks.** Caribbean banks need access to the global financial system. Loss of US CBRs cuts off livelihoods across the region, and Chinese CBRs can become a suitable alternative to ensure that access remains.

3. **Chinese banks do not face the same regulatory pressures as US banks, so they are less likely to be deterred by perceived risk in the Caribbean.** If more Caribbean banks turn to Chinese banks, US authorities' regulatory capabilities are limited. It is not possible to oversee Chinese-Caribbean transactions to a similar extent as US processed ones.

4. **The increased use of Chinese RMB can affect US-Caribbean trade.** Many of the products imported from the United States are made in China. Using RMB to purchase goods directly from China instead of going through the United States is economically more feasible with greater use of China's currency.

5. **As Taiwan's allies lose more CBRs, there will be increased domestic pressure from the private sector and banks to find new ways to access global markets.** In this vein, Chinese banks and CBRs become more attractive, and can be a factor for a potential diplomatic switch to China.

The Potential for Rising Instability and Shadow Banking

De-risking in the Caribbean has security implications for the United States. Greater challenges to sending and receiving money through legal means increase the likelihood that banks and other financial actors will look for alternative avenues. This is referred to as "shadow banking," which are networks often used to hide criminal and terrorist activities. Use of these networks makes them more robust and stronger—and, thus, harder to bring down. In this case, heavy regulatory requirements set by the United States and European countries have an unintended effect of pushing more actors to engage in illicit banking. Ultimately, this limits international authorities' ability to regulate banking channels as more move into the "shadows." This presents a national security risk for the United States due to the Caribbean's proximity to countries that house illicit actors, such as Venezuela and Cuba. Increased shadow banking, coupled with limited regulatory capabilities, exposes the Caribbean to becoming a future hub for criminal financing.

Caribbean economic instability caused by de-risking has indirect US consequences as well. As mentioned, CBRs are critical for remittance flows and trade. These three areas underpin economic development, growth, and sustainability. Remittances are essential to the GDP of many countries, and are essential to the livelihoods of working-class populations. Loss of remittance flows can drive more people into poverty. Limited trade and access to global finance hinders MSMEs, which comprise a large portion of employment in the Caribbean.

The combination of increased poverty and unemployment creates two main security challenges for the Caribbean and the United States. First, loss of livelihoods through poverty and job loss creates incentives for people to engage in criminal activities to sustain themselves. This can include petty theft or joining criminal organizations. Rising crime, through increased membership of gangs—especially those participating in arms, drug, and human trafficking—worsen regional security conditions. It can increase the illegal transport of drugs and arms to US borders. Second, poverty and unemployment are also factors that drive in-state and transnational migration. Migration from rural to urban areas creates more space for competition of jobs, which can lead to small conflicts and violence. This, combined with impoverished living conditions, can drive migration to US borders.

Actions Already Taken

US and Caribbean policymakers have taken first steps to address de-risking. In 2019, a contingent of Caribbean leaders from Antigua and Barbuda, Saint Lucia, Trinidad and Tobago, and Barbados met with US Congresswoman and Chair of the House Financial Services Committee Maxine Waters to discuss the implications of de-risking.[20] The outcome was Section 6215 of the 2021 National Defense Authorization Act (NDAA), which underscored the effects of de-risking on US objectives, security interests, and the well-being of developing regions such as the Caribbean.[21] From the United States, the inclusion of de-risking is concrete recognition that broader financial exclusion in the Caribbean has adverse effects on its own interests. Section 6215 identified de-risking as: vital to providing humanitarian and development assistance abroad; a deterrent to remittances from the United States; and a driver of more banking relations into unregulated channels. The result of section 6215 of the 2021 NDAA was a report by the US Government and Accountability Office (GAO) on how to improve banking access for countries deemed as high-risk jurisdictions. The report acknowledged several key points often made by Caribbean leaders, representatives, and institutions, including that high costs attributed to conducting due diligence result in the withdrawal of CBRs. It also noted that regional bank representatives face "uncertainty about regulatory expectations" to meet compliance standards.[22] Convergence between the United States and the Caribbean is a key component of creating policy and agreements. Today, de-risking enters the convergence category alongside other interests—such as climate change, the COVID-19 pandemic, and security concerns.

RECOMMENDATIONS

The Caribbean Financial Inclusion Task Force identified a range of ways in which the United States, multilateral institutions, Caribbean governments, and the private sector can work together to address the many challenges presented by de-risking. Below are the top-four overarching recommendations from the Task Force.

1 *Using a regional mechanism to increase transaction volumes:*

Relative to other jurisdictions, the small volume of transactions from Caribbean countries makes correspondent banking less profitable for smaller banks. International financial institutions, such as the Inter-American Development Bank, the World Bank, and/or the International Monetary Fund should work with Caribbean governments and their central banks to create a regional grouping or mechanism that pools transactions to a size that is profitable for bigger correspondent banks. Simultaneously, the US Department of Treasury should work with the Caribbean Association of Banks and the Caribbean Financial Action Task Force to build technical capacity, and facilitate knowledge sharing and data gathering, for Caribbean central and local banks.

2 *Setting consistent standards for international compliance:*

Caribbean countries have trouble fulfilling international compliance standards, due to limited transparency from global regulatory bodies and few resources to meet these standards. The United States—as a critical ally with global influence—can help Caribbean countries receive more clarity and install mechanisms that institutionalize a transparent and consistent set of international compliance standards. Addressing challenges to de-risking and its implications in the Caribbean should be included in the Caribbean Basin Security Authorization Act (fiscal year (FY) 2021–2022) to provide additional resources that complement the below recommendations.

- The US Department of Treasury should work to install a mechanism that standardizes compliance requirements annually, facilitates technical trainings that help Caribbean respondent banks meet these requirements, and brings in a third-party, autonomous institution to evaluate Caribbean respondent banks' progress in meeting the predetermined standards. Having a transparent set of criteria can help create a pathway for gray- and black-listed jurisdictions to alleviate this constraint.
- On a quarterly, virtual basis, the US Agency for International Development (USAID), the US Department of Treasury, and the Bureau for Economic and Business Affairs at the US Department of State should work with Caribbean central and local banks and regional organizations—such as the Caribbean Association of Banks, the Caribbean Financial Action Task, the Caribbean Development Bank—to build technical capacity, knowledge sharing, and data gathering to help correspondent banks and the region better understand and comply with international standards or requirements. Smaller countries, such as those in the eastern Caribbean, have limited resources and human capital to address international compliance requirements consistently.

3 *Categorizing correspondent banking as critical market infrastructure:*

The US Department of Treasury, congressional legislation, and international financial institutions should consider identifying correspondent banking as critical market infrastructure. Similar to SWIFT, CBRs are integral to the functioning of the global economy, particularly for developing countries like those in the Caribbean. Identifying CBRs as critical market infrastructure would provide global recognition to the importance that correspondent banking services provide to the health and ability for growth of Caribbean economies and citizens. This determination would provide a basis for international financial institutions and countries, such as the United States, to incorporate access to CBRs into aid and development packages.

Conceptualizing CBRs as a key dimension of the cross-border payments process can help to refocus regulatory actions and efforts on the dual objectives of reducing the risks of illicit transactions and ensuring that legitimate trade financing, payments, transfers, and investments upon which the region relies can continue to flow with minimal disruption.

4 *Establishing an annual US-Caribbean banking forum:*

As de-risking continues, keeping or building new relationships with US correspondent banks is a challenge. As noted, bigger correspondent banks find working in smaller jurisdictions less profitable due to rising compliance costs or the fear of heavy penalties. However, for small to medium-sized US correspondent banks, providing correspondent banking services to Caribbean jurisdictions can be profitable. The challenge is relationship building.

Therefore, the US Department of Treasury, Caribbean governments, and international financial institutions should consider hosting an annual hybrid-banking forum that brings smaller jurisdictions and correspondent banks together to facilitate relationship building and strengthening. The forum should be built along with support from the Caribbean Association of Banks and the Florida International Bankers Association, and inputs from CARICOM governments. The forum could act to alleviate correspondent banks' concerns prior to de-risking and help Caribbean banks understand more clearly the standards they are expected to meet to maintain a CBR. It should include in-person technical trainings between regulators and Caribbean respondent banks, and have an annual declaration signed by all participating entities to continue addressing de-risking and building new correspondent relationships for the Caribbean.

The US Congress many opportunities to simultaneously address the challenge of de-risking in the Caribbean and secure US interests in the region., April 29, 2020. (UNSPLASH/Quick PS)

CONCLUSION

As the pandemic continues and climate change worsens, access to the global financial system via correspondent banking is essential to the Caribbean's recovery, development, and stability. Trade, international finance and credit, and investment opportunities are severely hindered when CBRs are lost. Key Caribbean economic sectors, such as the tourism industry, lose out. And, smaller banks and businesses are faced with fiscal constraints that can lead to closures or defaults when loans or debts are not serviced.

Due to the important role CBRs play for the Caribbean and other small nations, correspondent banking is effectively a public good and/or critical market infrastructure. Correspondent banking is intimately connected to the lifeblood of development and financial inclusion. The withdrawal of these services affects governments, businesses, and the day-to-day lives of Caribbean citizens.

Given its importance to the global financial system, the SWIFT network and the transactions that it facilitates are considered by regulators to constitute a CFMI. CFMIs have been singled out by global regulators and central banks because financial systems, institutions, and economies that rely upon them would find it difficult—and, in some cases, impossible—to continue functioning if they were somehow impaired or cease functioning. Given the extreme reliance of Caribbean countries on the cross-border flow of capital, the rapid and accelerating loss of CBRs should motive regulators—both within the region, and in countries for whom the region's wellbeing is crucially important—to begin viewing correspondent banking as a critical market financing and infrastructure for the region. At the extreme, the SWIFT network (and others like it) cannot function if the banks that use it are compelled to withdraw from the system. This quantifiable abandonment of the sector and region has many antecedents, including increased regulatory and compliance burdens, and related costs and risks among normal de-risking driving factors.

The United States has a role to play in helping the Caribbean address de-risking, given how it affects US strategic interests. Limited purchasing power as a result of the indirect effects of de-risking affects US suppliers of goods and services to the Caribbean. Loss of US CBRs and the dollar opens a space for Caribbean government and banks to further engage with Chinese currencies and financial institutions. And, the job loss and poverty induced from the withdrawal of CBRs can increase crime and membership in organized crime throughout the hemisphere. Working with international partners, financial institutions, and regional governments, the United States can lead a new effort to protect Caribbean livelihoods against further de-risking by creating a transparent set of compliance standards, the tools to reach them, and new banking relationships. Doing so can create a hopeful Caribbean future and strengthen the region's relationship with the United States.

The Caribbean Initiative's 2021 Financial Inclusion Task Force looks forward to using the data, recommendations, and arguments made in this report to work with US and Caribbean stakeholders to promote the broader financial inclusion of the Caribbean by advancing strategies that minimize de-risking.

ABOUT THE CARIBBEAN INITIATIVE AND ITS FINANCIAL INCLUSION TASK FORCE

In February 2021, the Adrienne Arsht Latin America Center launched the first programming for its Caribbean Initiative. The initiative was created to raise the profile of the Caribbean's priorities with US and global stakeholders, while advancing new, innovative ideas that deepen US engagement with the region. In its first year of programming, the initiative has launched a Financial Inclusion Task Force, a high-level US-Caribbean Consultative Group, and a report on the strategic importance of sending US vaccines to the Caribbean, and has hosted regional heads of state and government, ministers, and ambassadors at its public and private convenings.

The initiative set out to tackle the critical issue of de-risking by launching its inaugural Financial Inclusion Task Force. The task force is a collection of representatives from correspondent banks, respondent banks, and regional organizations across the United States and the Caribbean. It convened for a total of six meetings from April to September 2021 and tackled topic areas, such as understanding the scope of the de-risking issues, stumbling blocks hindering regional banks from reaching international compliance, and implementable solutions to current challenges presented by de-risking. In addition to these meetings, the Caribbean Initiative team held individual consultations with task force members on a regular basis, and met with representatives from the US Department of Treasury, the House Financial Services Committee, the US Government Accountability Office, the Bank of Jamaica, and the Central Bank of Barbados.

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Disclaimer: Task force members endorsed the report in their individual capacity, and not that of the institution with which they are affiliated.

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About the Task Force Director

Jason Marczak is senior director of the Atlantic Council's Adrienne Arsht Latin America Center. He joined the council in 2013 to launch the center and set the strategic direction for its work. In 2021, he led the establishment of a Caribbean Initiative at the center, with it quickly becoming a top reference point for the analysis and advancement of US-Caribbean priorities. Since 2016, Marczak is an adjunct professor at the George Washington University's Elliott School of International Affairs. He was previously director of policy at Americas Society/Council of the Americas and co-founder of *Americas Quarterly* magazine. Marczak has more than twenty years of expertise in regional economics, politics, and development, working with high-level policymakers and private-sector executives to shape public policy.

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Wazim Mowla is a Guyanese American and is the assistant director of the Caribbean Initiative at the Adrienne Arsht Latin America Center. Mowla is also a nonresident scholar at the Florida International University (FIU) Jack D. Gordon Institute for Public Policy. Mowla holds a bachelor's degree in international relations and master's in history from FIU, as well as a master's from American University's School of International Service. Mowla frequently provides English-language commentary to US and Caribbean media outlets.

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