De-risking and its impact on Correspondent Banking in the Caribbean

BY: GLENFORD YSAGUIRRE
CENTRAL BANK OF BELIZE

Structure of the presentation

1. Understanding what is de-risking
2. The underlying causes
3. Threat to correspondent banking
4. Economic and financial impact
5. The Way Forward

1. Understanding what is derisking

1.1 What is de-risking?

- Sometimes also referred to as de-banking
- Withdrawal of services from certain classes of customers to evade associated regulatory risk
- Withdrawal from countries that are under geopolitical sanctions
- Started some fifteen years ago after 9/11
- Mostly with certain categories of domestic customers considered as most vulnerable to AML-CFT breaches
- Now extended to correspondent banking in less developed jurisdictions

2. The Underlying Causes

2.1 What gave rise to it?

- As early as 2001 regulators identified correspondent banking as weak link in the payment system chain
- Shell banking and international financial services sector came under sharp scrutiny
- Regulators in US and UK were given more powers to prosecute banks for poor compliance
- Prosecutors and regulators in the US applying much stiffer standards than the Financial Action Task Force (FATF)

2.2 What gave rise to it?

- Heightened AML-CFT regulations and geopolitical sanctions mostly introduced after 9/11 and the recent global crisis
- New laws and regulations which imposes much more stringent governance and reporting requirements for AML-CFT threats and to mitigate "**too big to fail**" systemic risk:
- Sarbanes Oxley Act of 2001;
- Patriot Act
- Dodd-Frank Act 2010;
- FATCA
- Basle III requirements

2.4 What gave rise to it?

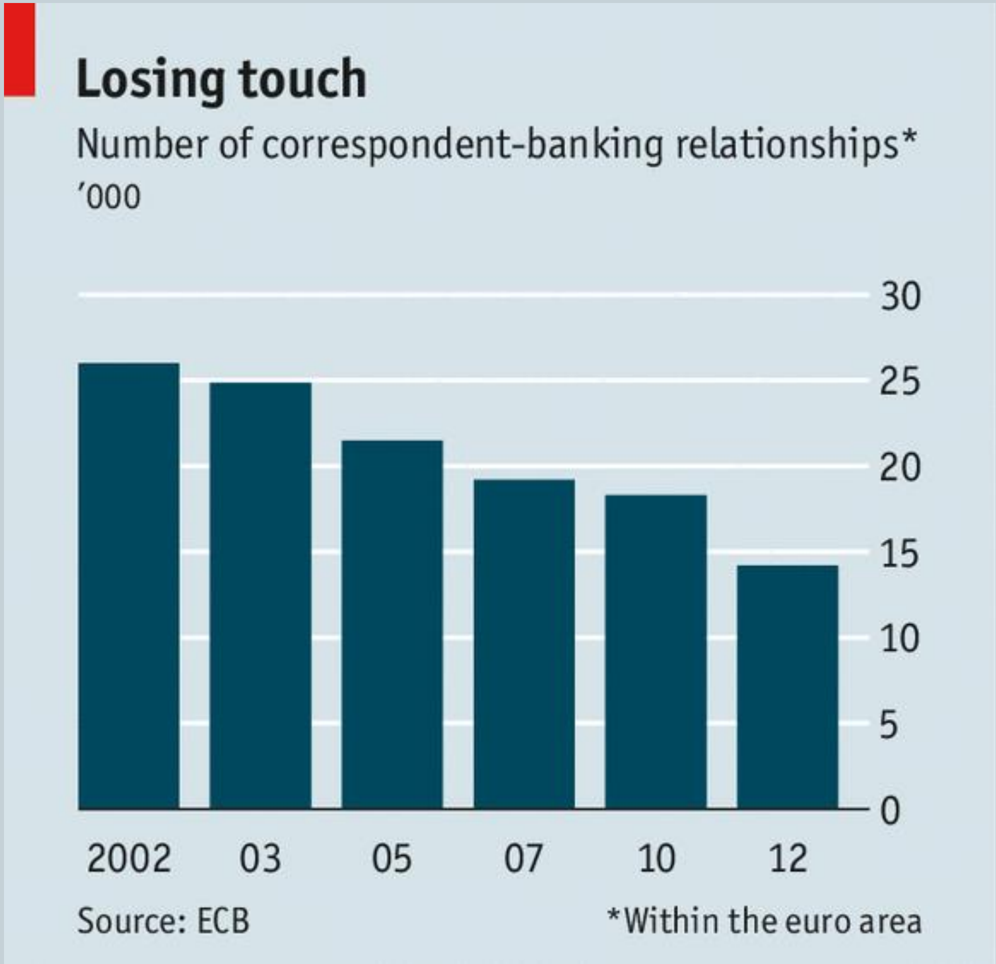
- The costs of compliance with requirements of home regulators are too high compared to the expected returns from certain lines of services
- Extremely onerous financial penalties for non-compliance and violations;
- Threat of fines and jail penalties for bank executives
- Rigorous stress testing for remote but plausible scenarios that may threaten systemic banks

2.3 What gave rise to it?

- US (and EU) regulators pushing and enforcing these laws and reporting standards that goes above and beyond the international requirements;
- Increased breadth and depth of compliance regulations within the US;
- Global banks that are also anchored in the US must comply
- Compliance also extend to their operations outside the US
- This has forced global banks that are anchored in these jurisdictions to retreat from certain markets to reduce compliance cost and regulatory risk faced at home

3. Impact on Correspondent Banking

3.1 From The Economist magazine Poor Correspondents (Jun 14th 2014)



3.2 Recent fines paid by global banks

- BNP Paribas - **$10 billion** (geopolitical sanctions)
- HSBC – **$1.9 billion** (AML violations)
- Citigroup/Banamex USA - **$140 million** (AML)
- UBS - **$780 million** (Tax violations)
- Commerzbank - **$1.5 billion** (geopolitical sanctions)
- US Banks – fined over **$100 billion** for mortgage fraud & foreclosure abuse since the crisis
- BOA leads the way with some **$58 billion**

3.3 Threat to Correspondent Banking

- Logical decision for global banks is to retreat
- To deliberately and systematically withdraw or withhold certain service lines including correspondent banking services from certain clients, i.e. de-risking
- Regulators argue that banks do not have to de-risk to comply
- The reality is that compliance cost now outweighs returns
- Those clients whose businesses are most vulnerable to AML-CFT and Tax violations became the first class of clients to be de-risked
- Then with the advent of KYCC a larger segment of the market fell into the un-bankable class
- Those included banks in developing economies across the globe

3. 4 Threat to Correspondent Banking

- The result is that small jurisdictions like ours across the globe are left in a lurch;
- We were largely dependent on a few global banks who had consolidated and blanketed the globe in search of new growth opportunities in the late '90's – 00's.
- Ironically, this comes at a time when Caribbean jurisdictions have also invested heavily from our scarce resources to bring our jurisdictions up to the international standards set by FATF/CFATF.
- But we are now being told by global banks that effort alone is not enough;

3.5 No Clear Rules to De-risking

- Banks given 3 months notice at best, possible 1-2 month extension
- But, it takes the better part of 6 months to negotiate a new relationship, if you are fortunate enough to find an interested bank
- You are not being told by either the de-risking bank; their government or their regulators what are the steps necessary to restore lost relationships
- Central Banks are being pressed into new areas of service to assist and stave off economic disaster

4.0 The Economic Impact

4.1 Role of IFI's

- Global assessment of economic and financial impact
- Law enforcement and regulators have narrow focus on AML-CFT and mitigating domestic risk ;
- Overlook cost and consequences for legitimate economic activity.
- Solution requires a global political and economic approach;
- New regulatory regimes require comprehensive impact assessment before implementation;
- Once again the plight of small countries are being treated as a late after thought

4.2 Negative Impact of Loss of CBR

- Negative economic impact
- Forces International Financial Services sector out of business
- Marginalization of small jurisdictions
- Increase in the cost of doing business in small economies
- Disruption of Remittance Flows
- Loss of trade financing arrangements
- Undermines domestic AML-CFT efforts as remittances will flee to unregulated channels

5.0 The Way Forward

5.1 The Way Forward

- We need to act collectively to get the desired attention from the developed world
- Coordinated response: Caribbean must partner with other regions e.g. Latin America, APC’s etc.
- Get the mainstream media in the US to cover our plight in its true light
- More often than not, our countries are vilified as uncooperative perpetrators or just necessary collateral damage rather than as victims
- The IFI’s can assist in this regard but they seem to lack the political will at this stage

5.2 The Way Forward

- Commonwealth Secretariat has sought to champion this cause on behalf of affected Commonwealth countries;
- The CS study focuses on the de-risking of MBS and the impact on remittances;
- The IMF, WB and others can focus their efforts along the same lines as it relates to trade financing, the cost of doing business, economic stability etc.
- FATF/CFATF can assist by engaging US authorities to incorporate their concerns into the international framework and reinstitute a universally accepted standard

5.3 The Way Forward

- New SWIFT product – SWIFT KYC Registry
- Alternative services providers for low value cross border payments, e.g. Earthport PLC and RVB Currency UK
- Focus search for new relationships away from global banks that carry a higher systemic risk profile in their home jurisdiction
- CAB must reach out to other bankers association in US
- Urgently address any deficiencies in our AML-CFT regimes and framework

END