De-Risking and its impact

STRUCTURE OF PRESENTATION

- **Caribbean Project on De-Risking**
  - Goals
  - Research Findings
- **Impact Throughout the Caribbean**
- **Technical Measures**
  - LEI, KYC utilities, Information Sharing
- **What must be done**

Caribbean Project on De-Risking

The Caribbean Project on De-Risking involves the compilation of information, to document and analyze the impact of de-risking strategies on our financial systems, and to prepare a position that will inform a Caribbean perspective on this matter.

Our efforts have led to a regional approach on this matter, and serve to complement efforts, we are individually engaged in, through the World Bank and the 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 complement this information with discussions with local regulators, central bankers and sector specialists.

Goal of our Research

The goal of our research is to facilitate discussions on de-risking in the Caribbean 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. Nonetheless, the rising cost of compliance with laws and regulations is also an unintended consequence of decisions taken by the official sector in globally systemic countries.

Research Findings

Correspondent banking is well recognized as providing a critical contribution to the global payment and financial system with cross-border transactions being facilitated to improve financial and economic stability throughout the Caribbean and the wider world.

In many Caribbean jurisdictions, there has been a recent trend of "de-risking" adopted by global banks, which have led them to either terminate or threaten to terminate their correspondent banking relationships (CBRs) with local banks.

While globally, de-risking is emerging as an unintended consequence of several factors, regionally, the primary reasons highlighted are rising costs and uncertainty from regulatory and risk exposures affecting the incentive structure against certain classes of customer and certain kinds of transactions.

As a result, some customers, business lines, markets, and jurisdictions are being perceived as too risky and costly in terms of compliance and major banks have removed prime customers from their client lists for reasons having nothing to do with lax regulation or AML risks.

Research Findings

Our research shows that Caribbean Banks and Financial Institutions have been compliant and currently there exists no evidence of lax AML/CFT systems in the Caribbean and their developing economies. All CARICOM countries and British dependencies are committed to the international certification process of the Financial Sector Assessment Program (FSAP), Caribbean Financial Action Task Force (CFATF), and the Global Forum, and the region has also made commitments under 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 behavior which violates the rules.

What is more, perfect compliance is no guarantee of immunity from allegations that tarnish reputation, and are potentially costly, in terms of public relations or legal defense costs.

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

GUYANA

Guyana has been affected also.

With approximately 44%, close to half of Guyana's correspondent banking providers originate from the Caribbean (Trinidad & Tobago, Barbados and Jamaica). Guyana has experienced the least terminations.

Two (2) local banks' corresponding relationships have been terminated or restricted over the past 24 months.

One bank experienced terminations as well as restrictions of 50 percent of its correspondent relationships, moving from eight (8) accounts in 2012 to four (4) accounts at the end of 2014.

The number of transactions conducted via the bank's correspondent declined by almost 52 percent, while the total value of such transactions fell by 27 percent.

Research Findings

Financial Institutions acting as correspondents rely on the respondent bank to put sufficiently robust Anti Money Laundering (AML)/ Counter Terrorist Financing (CFT)/Know Your Customer (KYC) frameworks in place to ensure that their customers are transacting legal business

The peer review system of Caribbean Financial Action Task Force (CFATF), to which all of 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).

Also, there is no international uniformity of the sanctions regime, and the designation of 'terrorist' nations, organizations or supporters varies by country.

Research Findings

For many 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.

To put the matter in strictly business terms, the average unit compliance cost is now so high as to be impractical for certain types of business.

What is even more troubling, is that, while all regulatory practices fully comply with FATF and Global Forum standards, and certified by peer reviews and FSAPs, international transactions are at risk for violating national sanctions and prohibitions in the US and elsewhere.

Caribbean 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 MSBs, while , the Bahamas ,the Cayman Islands and Turks and Caicos have lost their cash intensive business (money transfers).

Belize 's largest local bank, after termination have explored the possibility of having the central bank assisting with foreign payments, however the objection of 'nesting' was recently cited by the correspondent bank, resulting in customer migration and in Haiti all seven (7) local banks have experience terminations or restrictions in service.

Caribbean Impact

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 US$Ms.

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 percent in Guyana, while in Trinidad several entities have been 'unbanked" within the past 24 months.

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 IBCs 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 8 domestic financial institutions have had their accounts terminated by primarily Canadian, US correspondent banks, with a few banks from the Netherlands, UK and Germany also.

Several respondent banks and IBCs have had to seek alternative correspondent banking relationships in other jurisdictions for some of their lost terminations, however, most of the terminations being completely irreplaceable.

BARBADOS

IBCs have not only experience 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 now go directly to 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, there is great difficulty in the ease of doing business within the sector.

BELIZE

The Central Bank of Belize has reported that correspondent banking relationships have been terminated by their US correspondents in 5 of the 7 banks operating in the country, including the largest bank, Belize Bank.

In the case of the Belize Bank International Limited, the Central Bank has offered limited assistance for the close out of customer accounts, with these transactions being properly reported and disclosed.

Belize Bank International Limited, however, is still unable to service its remaining customers , who now complain directly to the US Embassy on the inability to access their funds.

THE BAHAMAS

Recent results from a Central Bank of Bahamas survey, confirmed that the risk appetite for correspondent banking appears to have lowered.

The survey data found that at least two (2) domestic commercial banks and four (4) 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 ML/TF 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.

CAYMAN, BAHAMAS & TCI - MVTS

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 transfers.

Specific cases include that of Fidelity Bank that ceased facilitating Western Union's operations at its branches and sub-agent locations. With reported unacceptably high risks and declining compensating fees, Western Union Offices closed in July 2015.

GraceKennedy Money Services has commence operations, including the repatriation of banknotes with the support of their banker.

Fidelity Bank (Bahamas) Limited and Fidelity Bank & Trust International in the Bahamas have closed its 20-year Western Union franchise in an attempt to "de-risk" its 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.

EASTERN CARIBBEAN CURRENCY UNION

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 as reported by a local banker.

Another bank has closed its entire operation in the entire 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 MSBs or cambios.

EASTERN CARIBBEAN CURRENCY UNION

The termination impact is estimated to involve the loss of several US$Ms over the past 24 months.

Like other jurisdictions, several local banks have had to reroute some of their lost relationships with other jurisdictions and banks, usually at a higher expediency cost and greater stringency.

For local banks who have maintained relationships, there has been onerous restrictions within the past 12 – 24 months, as correspondent banks have increased their standard charges by 10 fold in some cases and only recently another international bank imposed a fee for any balances above US$6m.

Local banks have been met with refusal to clear foreign denominated cheques and while others have been told that there will be no foreign cheque clearing for at least the next six (6) to twelve (12) months.

There has also been increased stringent regulatory requirements placed on local banks, especially with the opening of new accounts.

JAMAICA

In Jamaica there has been terminations and or imposed restrictions 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 notice to two (2) others, and has imposed restrictions on four (4) 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 business).

Money Service Businesses (Cambio Services) in Jamaica accounted for 46% of all sales in the financial intermediation market and generated FX inflows of US$ 470M in 2014.

In Jamaica 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.

JAMAICA

With concern on the potential of de-risking expanding to larger groups, Bank of Jamaica, has implemented a six (6)month moratorium on the surrender requirements of cambios to the central bank.

TRINIDAD AND TOBAGO

Banks have reported being attempting to avoid risks associated with certain categories of clients. The Central Bank of Trinidad & Tobago (CBTT) issued a statement (July 2015) stating 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 sixty (60) registered entities, provide recreational gaming in casinos, video games and entertainment through bars and pubs.

At the same period, there has also been increased pressure on Money Value Transfer Service (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 Private Members’ Clubs.

Technical Measures

The Committee on Payments and Market Infrastructures (CPMI) report (October 2015) states that in many jurisdictions, there has been a recent trend of "de-risking" adopted by global banks. Rising costs and uncertainty about how far customer due diligence should go was highlighted by the report as among the main reasons for terminations.

The report recommended a number of technical measures based around greater information sharing aimed at alleviating some of the concerns and cost issues related to CBR terminations.

From the report own analysis, it would appear that policy responses should be aimed at regulatory amendments and compliance related issues, versus any actions of greater information sharing mechanisms by private and public sector entities.

As these technical measures do not seem to address or will provide any resolution to the uncertainty of how far customer due diligence should go; neither will it assist banks without current access to regain their previous status. In addition, for jurisdictions with data privacy laws, the use of information–sharing technical mechanisms will not be allowed.

Technical Measures

More specifically, the Legal Entity Identifier (LEI), which is recommended by the report as a way to uniquely identify parties to financial transactions may support greater financial sharing and transaction screening, however the LEI could contribute to higher compliance cost, without diminishing uncertainty.

LEI generally assists where at least one party to the wire transfer is a legal entity, otherwise it's of little benefit.

Surprisingly the report did not include feedback garnered from non – CPMI jurisdictions, most of which are the most affected by the withdrawal of correspondent banking relationships.

What must be done

The joint study has confirmed that global regulators and international standard setters (FATF, CPMI 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, leading to certain international transactions becoming at risk for violating national sanctions and prohibitions in the USA and elsewhere.

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

The international community, including international institutions could also step up their support to Caribbean efforts in addressing these evolving regulatory standards that are contributing to the terminating of correspondent banking service in our economies.