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De-Risking

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Abstract

It is essential to have secure, stable monetary and worldwide payment frameworks that reduce exposure to Money Laundering and Terrorism Financing (ML/FT), while permitting access to markets and customers from vulnerable economies that are seen as high risk.

To accomplish this, all partners, including governments, national regulators, multilaterals, and worldwide banks, must help national respondent banks in building up their risk and compliance structures, enhancing training for front-line officers, and upgrading current back office frameworks. This will assist them to maintain existing connections between global banks and their local respondents.

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What is the Issue?

The Financial Action Task Force (FATF) defines de-risking as "the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risk in line with the risk-based approach." At this point, it is not entirely clear if customers are being de-risked to prevent money laundering and the financing of terrorism (AML/CFT) and the proceeds from nefarious activities to have access to financial systems, or if legitimate clients, transactions, and jurisdictions that are perceived as high risk or unprofitable are simply being kept out of global financial and payment systems (World Bank, 2016).

Whatever the underlying motives, there is a perfect understanding that de-risking involves the termination or restriction of financial services, limiting access by countries conducting business across borders with the support of a financial system that allows money to move efficiently and securely. Today, a broad cross-section of international transactions, including settlements on credit cards, foreign direct investments, remittances, and external flows, are encouraged through connections between global banks and national respondent banks. (World Bank 2016).

Caribbean countries' development and improvement are subject to the continued access to global exchanges. For small, open economies which depend on global financial transactions, payment settlements, and tourism, any threat to the financial and payment system could have a destabilizing impact.

A World Bank report issued in November 2015 found that the Caribbean region has been among the most severely affected by this de-risking strategy. International correspondent banking has either been terminated or restricted to several domestic respondent banks in recent years. Banks, building societies, offshore businesses, and other financial institutions in the Caribbean have been impacted. In fact, de-risking within the Caribbean is not only the result of real or perceived AML/CFT issues within individual institutions; international correspondent banks are also making decisions about their relationships within the context of the overall perception of the region as being either high risk or unrewarding. Thus, in an area where there is a large volume of legitimate transactions, such as remittances and offshore financial services, the perception of risk leads to enhanced due diligence, which in turn drives up costs.

From this standpoint, the decisions by global banks to end or limit correspondent banking can appear to be reasonable. As the cost of compliance rises, together with the real possibility of penalties and sanctions, certain jurisdictions, business lines, and clientele are less palatable, or in some cases, no longer feasible.

This exceptionally vexing issue will not be solved quickly. Nevertheless, the expectation of this brief is to examine some concrete steps that stakeholders can take individually or collectively to create a growing sense of certainty that we are heading in the right direction.

What, then, are the forward-leaning solutions that will help to alleviate these problems, with the hope that global banks and respondent banks can proceed with their relationship and maintain financial and payments frameworks throughout the region?

The Need for Open Dialogue

There is a need for open dialogue between the key stakeholders that contribute to the goal of sustainable and inclusive banking. Any dialogue must be solution-oriented, which will help to balance risk, compliance, and cost.

Discussions must outline the context and challenges for stakeholders, and explore ways in which regional economies could enhance their compliance standards and improve communications to their local and international partners regarding their ongoing efforts to create a robust supervisory regime. Critical to the dialogue is the need for clarity on regulatory expectations and the rationale for terminations, restrictions, and sanctions. Respondent banks must also express their willingness to provide as much information as possible on their structures for relieving AML/CFT dangers. The CARICOM Heads of Government, understanding the gravity of this matter, have given it the highest priority. There have been greater efforts of advocacy and dialogue at different fora, including meetings of the Financial Stability Board, the International Monetary Fund, the World Bank, the U.S. Department of the Treasury, and the Inter-American Development Bank. (World Bank 2016, Wright et al. 2016).

The Role of Governments and National Regulators

When jurisdictions are considered too high-risk, governments and federal regulators can seek out new and creative ways to provide and maintain financial services, using due diligence utilities and accommodating the most extensive accessibility of shared client data among global and regional banks through the development of a centralized utility for monitoring, and sharing when necessary, transactional information. Mexico has demonstrated the usage of a centralized database of cross-border transactions accessible by correspondent banks.

National regulators should enhance efforts to show that they are comprehensively regulating perceived high-risk entities and business lines and provide open affirmation of their exercises to increase the comfort level of international banks (World Bank, 2016).

Increase Focus on Technical Tools

There should be emphasis on the practical tools that can help maintain current correspondent relationships and that can build and improve compliance structures. This would include greater usage of know your customer (KYC) utilities and legal entity identifiers (LEIs), allowing global banks timely access to client data and proving further guarantee that KYC requirements are being met. Most financial technology (fintech) companies, such as the Society for Worldwide Interbank Financial Telecommunication (SWIFT) and International Business Machines (IBM), can use block-chain technology and other measures (artificial intelligence and machine learning) to improve the reliability of client information and spotting suspicious transactions for correspondent and respondent banks, thereby reducing money laundering and terrorist financing (ML/TF) risks. (World Bank 2016).

Providing more Efficient Training, Creating more Transparent Compliance Guidelines

By helping nations enhance their AML regimes or supervision and regulation guidelines within the financial sector, international organizations and technical assistance providers will contribute to addressing ML/TF concerns, increase attractiveness of correspondent banking, and create common advantages for all stakeholders. Several multilateral (Inter-American Development Bank, International Monetary Fund, and World Bank) and some regional (Caribbean Development Bank) agencies stand ready to assist local jurisdictions and respondent banks, especially domestic banks, which have been severally impacted.

Conclusion

It is important to have secure, stable financial and global payment systems that reduce exposure to the ML/FT but allow access to jurisdictions and clients from small, open economies that are viewed as high-risk.

To help achieve this, all stakeholders, including governments, regional regulators, multilateral agencies, and global banks, must assist national respondent banks in developing their regulatory frameworks, improving training for regulatory compliance officers, and enhancing current back office systems. This will help them to maintain existing relationships between international banks and their local respondents.

Increased efforts are needed to advocate for improving the clarity of regulatory standards. They need to be applied consistently across the financial sphere, and global banks must be encouraged to apply due diligence even as they attempt to reduce their risk profile and protect their brand.

A great deal is at stake, including the continued viability of our local banking relationships and financial sector. All stakeholders, therefore, must continue to work in alliance with regional and international initiatives in dealing with this multifaceted, intriguing issue of de-risking and prevent a rupture of banking relationships.

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