DISCUSSION PAPER

STRATEGIC SOLUTIONS TO 'DE-RISKING' AND THE DECLINE OF CORRESPONDENT BANKING RELATIONSHIPS IN THE CARIBBEAN

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ABSTRACT

This paper focuses primarily on solutions and mitigants to the problems arising from restriction of financial services and withdrawals of correspondent banking relationships (CBRs) which is popularly known as "de-risking" or "de-banking". It argues that there is no silver bullet; no one-size-fits all solution to this problem. Although affected regional stakeholders are facing a common threat, each country and regional financial institution is also facing unique problems that will require bespoke solutions. It proposes that as a complement to the coordinated regional approach of high-level political diplomacy, (which is supported by the Caribbean Development Bank [CDB]), a simplified tailored and robust "horses for courses" approach may also be pursued by stakeholders to identify their most relevant, practical, workable and preferred solutions by matching them to relevant causes and drivers. This approach assumes that it is possible to target specific countries and institutions with tailored solutions which will make it easier for stakeholders to refine their plans and implement solutions on a case-by-case (country-by-country and/or institution-by-institution) basis.

Part A provides a brief background to key issues and the problem. It also outlines CDB's role to support its borrowing member countries and other stakeholders at the regional, national and institutional levels with technical assistance, advocacy and ideas.

Parts B to F conceptualise a simple and flexible approach (as one approach, not the only possible approach) to assist stakeholders who are worried about solutions. It provides intentionally simplified descriptions and illustrations of potential strategic solutions. It explains how the "horses for courses" approach can work. It describes how in complement to the regional approach, each regional, national or institutional stakeholder can also find, assess, refine and ultimately advance towards the implementation of strategic preferred solutions.

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A. INTRODUCTION

Correspondent Banking Relationships

1.1 Correspondent Banking Relationships (CBRs) exist between banks providing financial services (correspondent banks) and banks receiving those services (respondent banks). CBRs are fundamental to the efficient operation and resilience of the global financial system. They facilitate the re-allocation of capital, cross border payment systems and other services which are essential for international trade. CBRs also enable financial inclusion by providing to governments, corporations and ordinary citizens with access to a wide scope of globally networked financial services. In this way, they contribute immensely to the stability of the Caribbean's economic, financial and social ecosystem.

1.2 However, today Caribbean stakeholders at the regional, national and institutional levels are justifiably concerned by and are giving much attention to increasing restrictions of financial services and withdrawals of CBRs, undertaken by some large correspondent banks.

A looming systemic crisis

1.3 A key global concern is that if left unchecked, this issue could lead to systemic risks in the regions adversely impacted and ultimately impact the stability of the global financial system, global trade and global competition. It can be detrimental to the promotion of financial inclusion and increase use of the unregulated and opaque shadow banking system.

1.4 Regionally, there is a looming risk of systemic economic and financial impacts if this issue is not addressed. The Financial Stability Board (FSB) in its recent Report to the G20 on efforts to assess and address the decline of correspondent banking (FSB's Report) noted that the decline of CBRs in the Caribbean could become a systemic issue for the Region. It warned that by driving payment flows underground into the shadow banking sector, the decline in CBRs could exacerbate the region's challenges with being classified as 'high risk' for financial crime, particularly money laundering and terrorist financing.

1.5 The most recent regional response to this issue is a call for Caribbean stakeholders to wage a coordinated relentless campaign against conduct popularly referred to "de-banking" or "de-risking" to avoid it becoming an existential risk and potentially systemic crisis with cataclysmic ramifications to our regional banking sector[2].

Defining and Distinguishing De-risking

1.6 De-risking means, in this context, the inappropriate restriction of financial services, or withdrawal of a CBR, often with little or no notice undertaken to avoid, rather than to manage risks. Unfortunately, some confusion is being created because the term 'de-risking' is being popularly used to mean many different things including every severance or restriction of a CBR. However, not every restriction or severance of a CBR is "de-risking". Some prominent US regulators have pointed to this difference between appropriate actions pursuant to risk assessments and inappropriate de-risking[3].

1.7 One view is that de-risking is too often mistakenly conflated with 'pre-risking' and re-risking'. Pre-risking describes the situation where a correspondent bank conducts an appropriate risk-based preliminary assessment of a potential relationship but declines to enter a CBR. Re-risking describes the situation where a correspondent bank conducts an appropriate case-by-case risk-based reassessment of an existing, 'on-boarded' CBR which determines that it cannot manage the risks associated with continuing the CBR and thus terminates it. All three terms describe actions that: (a) can occur at both the international and national/domestic levels; and (b) may lead to financial exclusion particularly of the vulnerable, diversion of transactional traffic to the shadow banking system and other problems.

B. THE ROLE OF THE CARIBBEAN DEVELOPMENT BANK

1.8 CDB uses CBRs to deliver development assistance to our borrowing member countries (BMC). Although CDB has neither suffered from a restriction nor lost a CBR we understand first-hand the challenges faced by many stakeholders, particularly our BMCs. In that context, CDB can provide: (a) technical assistance (TA); (b) advocacy; and (c) ideas to support our (BMCs) and other regional institutions in common pursuit of the overall goals; the mitigants and solutions to this issue. CDB's assistance can aid the development of appropriate approaches to respond quickly and effectively to this problem.

Technical Assistance

1.9 Through the provision of TA, CDB is able to assist its BMCs to identify and counter threats to their economic stability and growth. CDB's work includes helping our BMCs to withstand or build resilience to the myriad of threats that they face including the withdrawal of CBRs, regardless of the causes. Specific to this issue, CDB has promoted consistently its willingness to provide TA for relevant studies to find solutions to this issue.

Advocacy

1.10 CDB has also advocated for a coordinated regional approach and added its voice to those of other international, regional, national and institutional stakeholders who caution against the withdrawal of CBRs and reject outright de-risking of CBRs.

Sharing ideas

1.11 CDB has participated in a number of meetings and roundtables on the subject hosted by:

- **(a)** Caribbean Financial Action Task Force (CFATF), held in Trinidad and Tobago in November 2015;
- **(b)** Financial Stability Board (FSB), International Monetary Fund (IMF) and World Bank (WB) held in Barbados in December 2015;
- **(c)** Caribbean Policy Research Institute held in Jamaica in January 2016;
- **(d)** CARICOM Heads of Government held in Belize in February 2016;
- **(e)** Caribbean Association of Bankers held in Miami in April 2016; and
- **(f)** United States (US) Government during the US-Caribbean-Central American Energy Summit on May 3-4, 2016.

1.12 At each of these meetings CDB contributed with commentary, shared its ideas and indicated its willingness to provide technical assistance to aid the search for solutions through the coordinated regional approach. CDB will continue to participate in these events to ensure that we are ready to deliver on our commitments in this regard.

1.13 We are sharing our insights through the Policy Brief that this paper accompanies which is titled 'Decline in Correspondent Banking Relationships: Economic and Social Impact on the Caribbean and Possible Solutions'. Through this paper we are also sharing our insights and ideas on how one-way stakeholders can advance the process of assessing and implementing solutions.

C. THE GOALS

2.1The search for solutions must be driven by achievable goals which reflect the ultimate aims of the key regional stakeholders. The following is a list (not exhaustive) of examples of possible goals that the search for solutions should target. Conceptually, this list is a starting point and should be expanded by stakeholders as appropriate but focused only on achievable goals as necessary in the short, medium and long term:

Examples of Short-term Goals

(a) recover lost CBRs;

(b) prevent the loss of current CBRs;

(c) close information gaps through interim mechanisms; and

(d) prepare for the return of lost CBRs.

Examples of Medium-term Goals

(a) reduce the number and stringency of restrictions imposed on current CBRs; and

(b) make CBRs more cost effective for correspondent banks.

Examples pf Long-term Goals

(a) diversify the range of robust CBR providers to regional institutions;

(b) close information asymmetries and increase understanding of the Region's risk profile particularly as it relates to Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) and corruption through more permanent mechanisms; and

(c) close or narrow compliance and regulatory gaps e.g. AML/CFT compliance that may increase the risk of future withdrawals of CBRs.

D. THE PROBLEM

3.1 This issue requires robust leadership, a profound sense of urgency from all stakeholders and careful planning to ensure that there is an efficient and strategic allocation of finite resources (human and financial) to the pursuit and implementation of solutions and mitigants. Regional stakeholders cannot afford to waste any time in finding solutions nor spend scarce resources testing unworkable solutions. Leadership, creativity, courage and support will be required in the conceptualisation, selection, financing and implementation of solutions.

The coordinated regional approach

3.2 The success of the coordinated regional approach being led by CARICOM is critical to the success of all stakeholders in working to meet the goals noted above. That approach should be supported at all costs because it is a top-down, high-level and political resolution which is critical to success of every solution and mitigant. There is also great strength in numbers and the strength inherent in that coordinated approach should be leveraged accordingly. However, stakeholders must also ensure that they balance credibly expectations of what can be achieved in the short, medium and long term and act with the required degree of urgency at the institutional, national and regional levels.

3.3 One critical concern is that although the coordinated regional approach is a preferred solution, it is at risk of becoming subjected to vicissitudes from outside of the Region. Among these challenges may be the availability and willingness of high-level counterparts in the US to effect real change now based on their own political cycle, pressure on regulators to avoid rolling back AML/CFT rules and limited reach of regulators to direct the large banks in their decision-making about which CBRs to restrict or sever. It could become increasingly difficult for Caribbean representatives to keep the process moving forward in carefully measured steps but in a way that reflects the urgency of the problem and gives them some measure of control over success of the outcome. These issues are discussed below.

Information Asymmetries

3.4 Information asymmetries are at the core of this problem and impacts decision-making at every level and on almost every related issue. Information asymmetries can lead to unproductive cross-talking among decision-makers and a general lack of understanding among all stakeholders on both sides of this problem.

3.5 A starting point is that the regional approach and indeed any other approach to finding solutions is complicated by the lack of specific information being provided by the large correspondent banks that are undertaking withdrawals or being accused of de-risking. This information gap is often filled by speculation which makes it difficult to arrive at solutions to problems that have not been clearly identified as problems; to make precise judgments about what to fix and whether a fix will work. This raises the risk of creating solutions to chase problems that do not really exist or are not really worth trying to fix. Caribbean banks may believe that their risk profiles are not well understood by US large banks and their regulators. Similarly US regulators and large banks may feel that they are not being well understood in the Region.

3.6 The coordinated regional approach will help to close these information gaps but existing shortcomings in the current communication dynamics among regulators, correspondent banks and respondent banks can help to illustrate this point. For instance, the most prominent driver of withdrawals of CBRs and de-risking is the concern about the extent to which correspondent banks can manage or need to avoid altogether, risks related to AML and CFT arising through the CBR. Correspondent banks are required to conduct risk assessments, reviewed by their regulatory examiners, to determine whether they can manage specific AML/CFT risks. Regulators are expected to use a risk-based approach to AML/CFT compliance.

3.7 It is very well known among regional stakeholders that the US is the most prominent domicile for large banks undertaking withdrawals of CBRs and thus its banks, bank examiners, financial regulators and financial regulations are being targeted in the responses to date. It is less well known that at there is a Bank Secrecy Act/Anti-Money Laundering Examination Manual (BSA/AML Manual) that provides guidance to bank examiners on sound risk management requirements for identifying, mitigating and controlling risks associated with money laundering and terrorist financing. The BSA/AML Manual covers the broad requirement for risk assessments of CBRs to be conducted. The BSA/AML Manual's primary AML/CFT risk mitigation requirement for foreign accounts from CBRs is that:

> *"U.S. banks that offer foreign correspondent financial institution services should have **policies, procedures, and processes** to manage the BSA/AML risks inherent with these relationships and should closely monitor transactions related to these accounts to detect and report suspicious activities. The level of risk varies depending on the foreign financial institution's **strategic profile**, including its **size** and **geographic locations**, the **products and services it offers**, and the **markets and customers it serves.**" (our emphasis)*

3.8 This need to give prominence to the Bank's strategic risk profile is not well understood by all stakeholders. A CBR is not an entitlement. It should be a carefully structured arrangement with clear entry and exit criteria. For a US correspondent bank, the decision to restrict or terminate CBR should not be a whimsical exercise and at some stage they may wish to reverse their decision to sever the CBR. The strategic profile of the respondent bank should be a key driver of the risk assessment that will determine whether the CBR should be opened, maintained (if already opened), restricted or closed. On May 5, 2016 the US announced several actions including key regulations and legislation to update, clarify and strengthen its own AML/CFT regulatory regime. These included amendments to the scope of customer due diligence to be conducted to pursuant to the BSA to determine ultimate beneficial ownership for legal entity customers. While it is likely that these rules will contribute to more de-risking, the US does "not believe that the beneficial ownership requirement would produce a significant "de-risking" effect." .

3.9 Among the many policies, procedures and processes that the US correspondent banks are required to have in place is "established criteria for closing the foreign correspondent financial institution account." Similar criteria could be in place that extends beyond AML/CFT to every type of restriction or withdrawal. At minimum, regional stakeholders would be keen to know exactly how this criteria is established and used to make decisions regarding restrictions or termination of their CBRs. Sharing more information on the specific problem(s), will enable regional stakeholders to know quickly what they need to target when looking for solutions that focus on the goals e.g. to retain current CBRs and/or recover withdrawn CBRs.

E. A SIMPLIFIED STRATEGIC APPROACH TO SOLUTIONS AND MITIGANTS

4.1 The problems mentioned above may appear to present a significant challenge but they also create an opportunity. The coordinated regional approach may work best when complemented by a more targeted approach or framework that enables stakeholders to select from a menu of workable options then assess and implement on a case-by-case basis. Such a strategy could help each regional, national and institutional stakeholder to focus their resources on pursuing solutions collectively and individually.

4.2 Much effort has been spent by the regional central banks, the World Bank, FSB, IMF, BCBS-CPMI, the Caribbean Project on De-Risking and other stakeholders in exploring causes, drivers and technical measures. This paper does not attempt to re-do the good work that those stakeholders have already produced. Instead. it leans on the World Bank survey's interview with large international banks and to offer an original simplified "horses for courses" approach that stakeholders may use as a starting point to achieve desirable sustainable solutions-oriented outcomes consistent with the short, medium and long-term goals outlined above.

Horses for Courses as a complement to the Coordinated Regional Approach

4.3 A key rationale for articulating this approach is that stakeholders may begin to expect too much of the coordinated regional approach to deliver a single quick long lasting solution. The stakeholders leading the coordinated regional approach must also be able to manage expectations about what success would look like. Some stakeholders urgently need a road map to solutions and the reality is that there is no one-size-fits-all approach; no silver bullet. Only very few solutions may apply across the board to every country. Although some drivers and causes are common, each country has a unique risk profile, drivers, challenges and sense of urgency.

4.4 For example, Country A's problems may be related to AML/CFT and in light of its urgency may best be resolved in 2016 by using solution #1. Country B's problem may be a low volume of correspondent banking traffic best resolved in 2017 by using solutions # 2, #4 and #6. Country C's problem may be international sanctions which may best be resolved in 2016 by using solutions #3, #5 and #7. Further, while some solutions may apply across the board others may have limited or no application and yet others may be applicable but not feasible.

4.5 Each jurisdiction and each financial institution has its own unique problems with its CBR relationship. Some of those problems are beyond their respective control and complicated by information asymmetries. It is helpful to assume that a case-by-case approach could also be a valuable tool. This paper assumes that it is possible to target specific countries and institutions with tailored solutions which will make it easier for stakeholders to refine their plans and implement solutions on a case-by-case (country-by-country and/or institution-by-institution) basis. The idea is simply that by assisting stakeholders to rationalise their own unique challenges, each stakeholder can begin efficiently to match specific solutions to specific causes and drivers i.e. match specific "horses" (solution) to their best suited "courses" (causes and drivers). They can then examine the pros and cons and the utility of each possible solution on a case-by-case basis.

4.6 This approach is likely to be helpful to regional policymakers, academic and think-tanks to pick apart each solution and then to cull or narrow the list in a way that can promote prioritisation of solutions and better resource allocation. Alternatively stakeholders may begin by targeting specific causes that may impact their specific countries or institutions. In this case stakeholders may simply start by listing each cause or driver and matching them to one or more solutions then rationalising the solutions to determine the most feasible one.

4.7 This approach assumes that in addition to a coordinated regional approach it is also possible to target specific countries and institutions with tailored solutions which will make it easier for stakeholders to refine their plans and implement solutions on a case-by-case (country-by-country and/ or institution-by-institution) basis. This approach ensures a measure of visibility across the board; that stakeholders get an objective panoramic view of the options available to each country or bank to address their particular problem and can quickly de-prioritize the ones that are not likely to be pursued.

4.8 This approach can also be used proactively by national and institutional decision-makers to plan for the likely loss of a CBR just as could help those who have already lost CBRs. It can serve as a starting point to help those who are ready to act urgently and have to carefully manage limited resources to find options that may work best for them in the short, medium and long term. It enables them to first focus on their own unique problems and then to assess which of the single or multiple solutions can work for them. The approach is also flexible and capable of much refinement. Causes and drivers can be substituted or amended just as easily as potential solutions can be substituted or amended.

Selection of the initial list of causes and drivers

4.9 To reduce subjectivity and in the interest of time (i.e. because the list of causes can grow and evolve), the initial list of causes and drivers used in Part F (below) is the same list of causes and drivers used by the World Bank (WB) Survey to which the large international banks responded.

The World Bank Survey (2015)

4.10 The WB Survey of the global decline in CBRs over the period 2012 to 2015 and released in November 2015 is the most prominent and important study to date that sought to identify and understand the drivers and causes of the decline of CBRs. WB with support from the Financial Stability Board (FSB) and the Committee on Payment and Market Infrastructures (CPMI) surveyed 110 banking authorities and 20 large banks and 170 smaller local banks worldwide to ascertain why large international banks have started terminating or severely limiting their CBRs with smaller local and regional banks in jurisdictions across the world. WB found that the Caribbean seemed be the region most severely affected by the decline in CBRs. The survey also noted that the US is by far the primary jurisdiction that is the home of financial institutions terminating/restricting CBRs followed by the UK, France, Germany, Canada, Italy and Spain and that the currencies most affected were the US dollar, the British Pound, the Euro and the Canadian dollar, currencies in which the majority of the Region's international transactions are conducted. The survey also found that the products and services impacted include international wire transfers, trade finance, check clearing, clearing and settlements and cash management services. The money transfer operators and other remittance companies were most affected together with small and medium domestic banks and small and medium exporters.

4.11 To manage scope, reduce subjectivity and in the interest of time (i.e. because the list of causes can grow and evolve), the initial list of causes and drivers used in Part F (below) is the same list of causes and drivers used by the World Bank (WB) Survey to which the large international banks responded. The WB noted that driver and causes can be divided between those that are economic or business-related and those that are more regulatory and risk-related. The World Bank Survey noted that large international banks engaging in withdrawals, restrictions and de-risking generally emphasized both the actual level of risk, regulatory AML/CFT and business-related concerns. Many of these banks were exiting simply because others were exiting and they feared being the "last man standing" rather than an individual assessment of the country's risk profile. The following graphic lists same16 causes and drivers to which the large banks responded in the World Bank Survey. This list will be used further below to help explain the proposed approach:

1	Concerns about AML/CFT risks
2	Imposition of International Sanctions
3	Non-Compliance with sanctions regulations
4	Overall risk appetite
5	Insufficient respondent CDD information
6	Lack of prfitability/insuffiecient volume
7	Respondent's high risk customer base
8	Respondent jurisdiction subject to AML Countermeasures
9	Inability/Cost to conduct CDD on respondent's customers
10	Correspondent legal, regulatory or supervisory changes
11	Imposition of (Corresp) domestic enforcement actions
12	Sovereign credit risk rating of respondent's jurisdiction
13	Impact of international financial reforms (non-AML/CFT)
14	Structural Changes to financial institution (merger etc.)
15	Compliance - pre-existing legal/regulatory requirement
16	Industry consolidation within jurisdiction

4.12 The following percentages of large international bank respondents considered the relevant issues to be causes or drivers of the decline in CBRs:

RESPONDENTS	CAUSES/DRIVERS
95%	concerns about money laundering and terrorist financing risks
90%	the imposition of international sanctions
85%	(a) changes in the overall risk appetite of the correspondent bank; and (b) lack of compliance with AML/CFT or sanctions regulations
80%	a) the lack of profitability of certain foreign CBR services and products; and (b) concerns about, or insufficient information about respondent banks' customer due diligence procedures for AML/CFT or sanction purposes
75%	(a) the presence of the respondent bank in a jurisdiction that was subject to counter-measures or identified as having strategic AML/CFT deficiencies by FATF or another international; and (b) respondent banks having customer base classified as "high risk" for AML/CFT
65%	inability or expense/cost required to undertake customer due diligence on the respondent banks' customers
45%	changes to the legal, regulatory or supervisory requirements
40%	imposition of domestic enforcement actions
35%	the sovereign credit risk rating of the jurisdiction(s) of respondent banks
30%	(a) impact of internationally agreed financial regulatory reforms (other than AML/CFT) and (b) structural changes to the correspondent bank and/or re-organisation of their business portfolio
25%	compliance with pre-existing legal/supervisory/ regulatory requirements
20%	industry consolidation within the jurisdiction

Selection of solutions

4.13 The solutions, information and suggestions used in Part F (below) are not exhaustive and as mentioned above can be flexibly expanded or narrowed accordingly by any stakeholder as appropriate. Simply put, stakeholders can: (a) see what specific causes they are impacted or (if unknown because the correspondent bank has not disclosed it to them) likely to be impacted by and (b) identify, assess and review their most relevant and preferred solutions on a case-by-case basis and to refine and implement them accordingly.

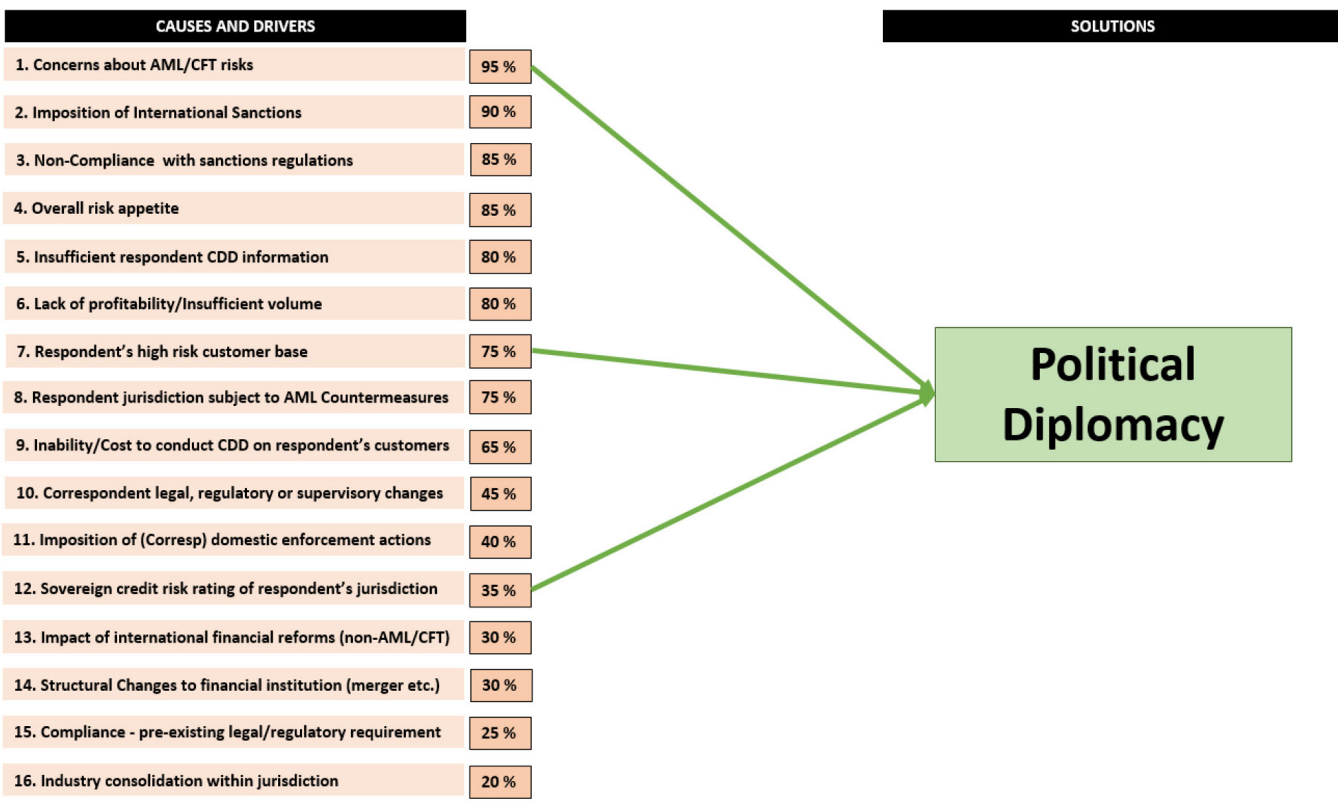
F. SOLUTIONS

5.1 This part lists solutions and provides a brief description of each solution together with a schematic showing the causes and drivers that may be addressed by that specific solution and some relevant pros and cons to consider. Stakeholders are able to refine these suggestions as necessary and ultimately to create a list of their own preferred solutions. This list is not exhaustive and solutions are not in order of priority. The solutions most potentially relevant applicable to the Caribbean are profiled briefly below.

LINKING POTENTIAL SOLUTIONS TO SPECIFIC CAUSES AND DRIVERS

Regional High-level Political Diplomacy

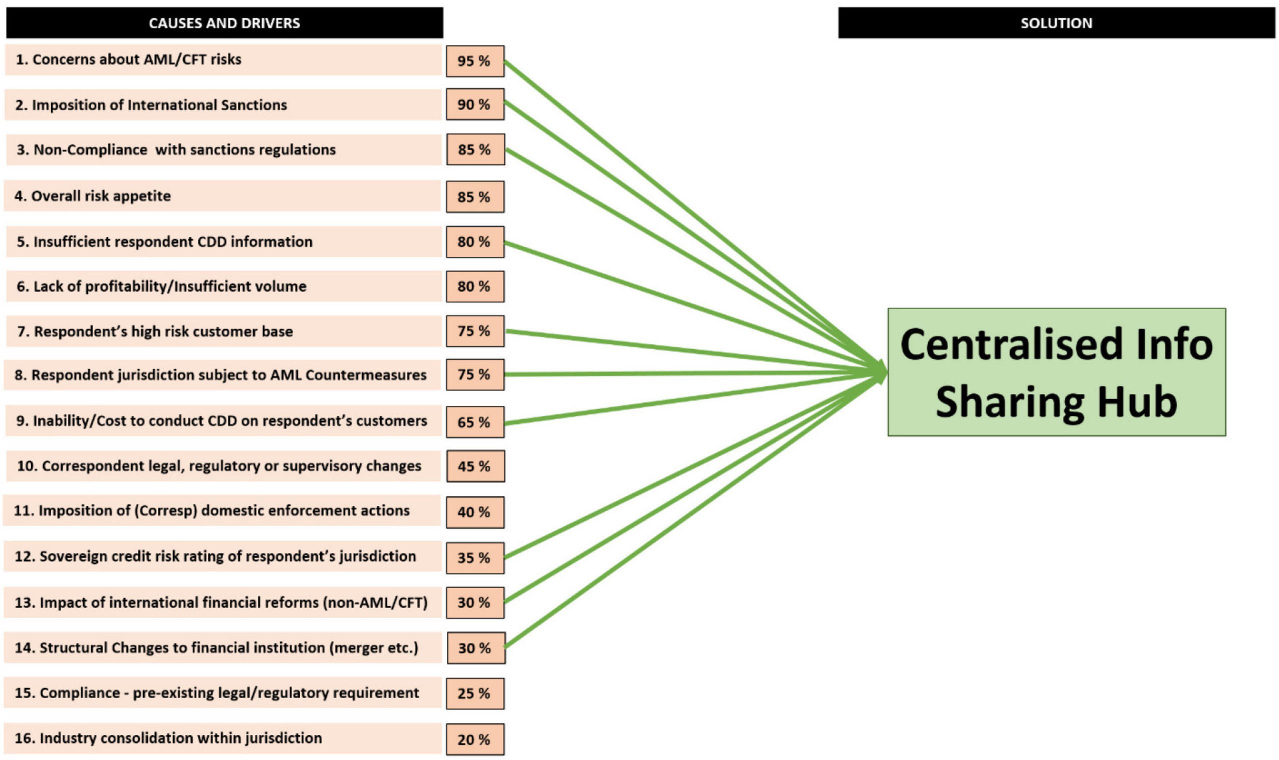
5.2 The decline in CBRs has already been met with an appropriate high-level politically driven response by Caribbean political leaders. A formal diplomacy-driven coordinated regional high-level political solution commenced at the 27th Inter-Sessional meeting of the Conference of the Heads of Government of CARICOM in Placencia, Belize on February 16-17, 2016 at which a high-level ministerial advocacy group was appointed to create greater international awareness and represent the interest of the Caribbean on this issue including at the United Nations, World Trade Organisation, and United States Congress. It is possible that this solution may only be able to respond effectively to three of the sixteen drivers and causes and its pros and cons are fairly balanced as illustrated on the tables below.



PROS	CONS
Enables top-down resolution	Will not work for every issue particularly those that are national and institutional specific
Escalates attention to the highest level among key decision makers	Could be impacted by political cycle, leadership commitments and other regional priorities

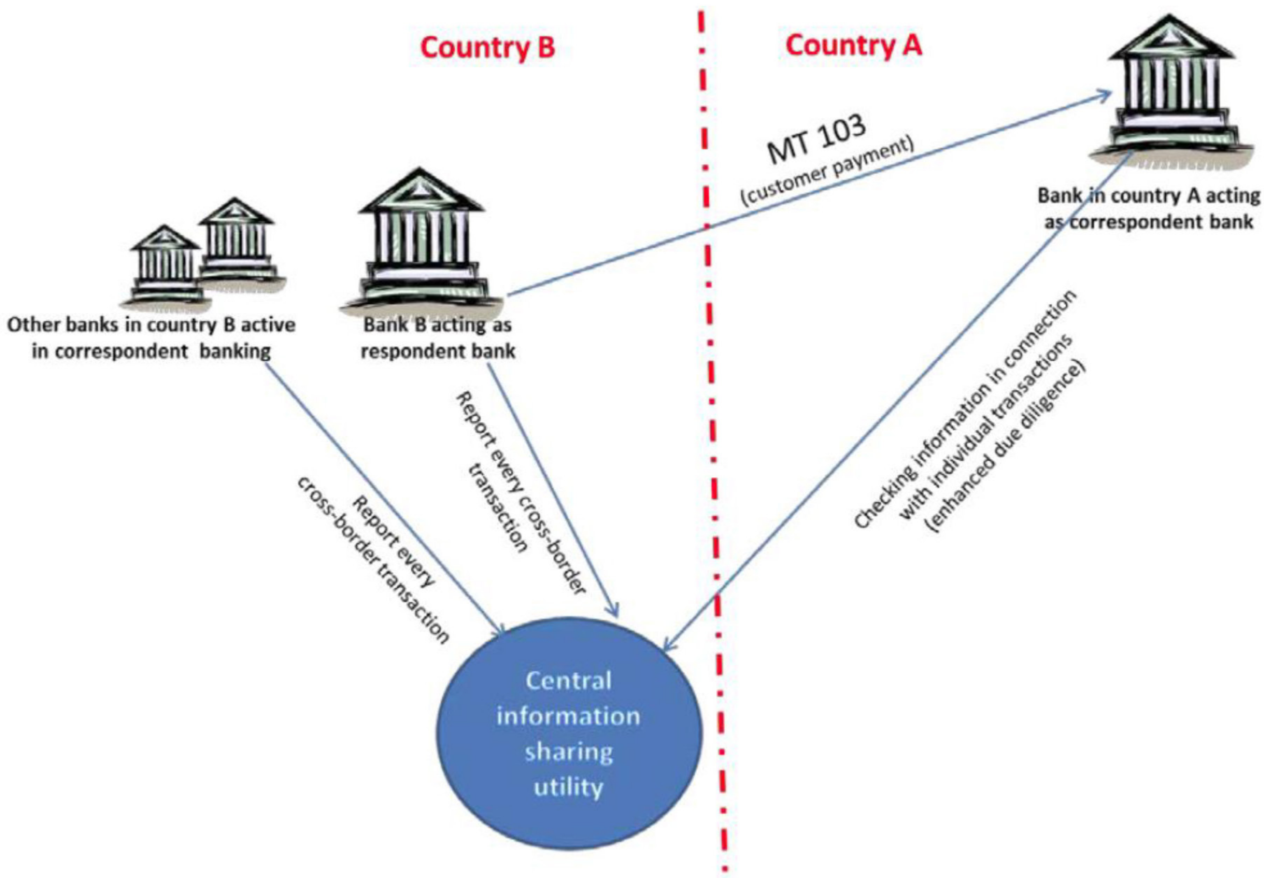
Regional and National Centralised Information Repository/Database and Sharing Hub

5.3 At the regional level, this solution requires the creation of single centralised information repository, reference hub or database on regional respondent banks. It can be used to hold and share information with correspondent banks conducting due diligence particularly on respondents' business and customers. This solution responds directly to the scope and quality of information relied on by correspondent banks to make decisions to maintain, restrict or sever CBRs based on risk assessments consistent with their own stringent statutory and regulatory KYC requirements to conduct detailed due diligence.



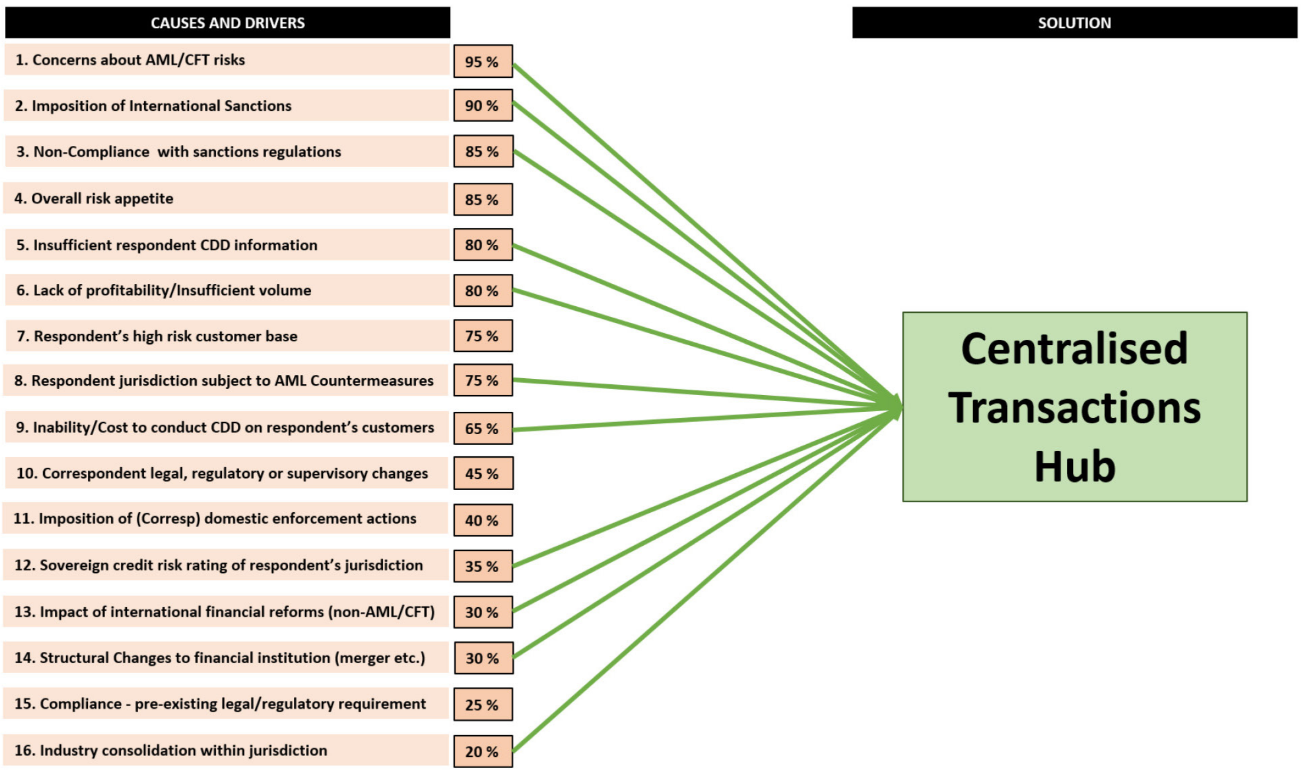
PROS	CONS
Can facilitate single regional recourse to mechanism for sharing of info by any respondent bank	Some countries may be required to enact or amend privacy laws
Can be used to pool KYC utilities	Security risk of concentration of highly confidential information may require support of a public authority
Reduce duplication in reporting	Data protection laws for collecting, storing and sharing information other related data privacy laws may need to be enacted or amended
Could enhance quality, reliability and credibility of information – better updated information	Does not remove responsibility on correspondent banks to conduct due diligence
Could facilitate aggregation of information and more comprehensive customer business profile	Inclusion of information on suspicious transactions could do more damage than good
Official support of a regional or national public authority may give users confidence	Operational risks on centralized information based depository could be high and create new challenges
Reduce costs of KYCC procedures, where applicable	Funding could be prohibitive
Precedent exists in Mexico. Other related centralized registers are emerging e.g. the EU 4th AML Directive requires states to keep centralized registers on ultimate beneficial owners.	Credibility and reliability of the hub itself will need ot be consistently high

5.4 Another option is for this centralised repository to be done at the national level in each Caribbean jurisdiction. This include support from national regulators to ensure that the national mechanism is sufficiently robust and is a reliable source of the right kind of information for CBR due diligence. The graphic below illustrates how the Mexican information sharing centralised database works and is an example to Caribbean stakeholders of how a similar mechanism can conceptually work within the region[14].



Centralised Regional Transactions Hub – Consolidation of regional transactions

5.5 The costs of CBRs is so relatively high that one option is to pool regional transactions through a single mechanism. This option may involve the creation of a new regional financial institution or use of an existing one to function as a hub or conduit for 'cleared' correspondent banking transactions traffic to the foreign correspondent banks. The costs of establishing and operating the regional transactions hub could be shared by the banks that use the facility and/or fully or partially underwritten (subsidised) by a regional financing arrangement or regional fund.



PROS	CONS
Attractive as a single transition point for appropriately "diligenced" transactions	It may be difficult to find a suitable regional entity or costly (time and resources) to create one
Cost effective – transactional volume will be high and will likely significantly reduce costs	Concentrated transactional traffic (if considered to be high risk) will make it a bigger target for de-risking
Transfers some key risks to regional entity that will know respondent customers well	Nature of facility and concentrated transactional traffic will generate a high level of operational risk
May work well if transactions are segmented by product, sector etc. and transactional traffic is high for each segment sufficient for highly rated CBR providers	May be difficult to achieve and maintain CBRs with significant correspondent banks due to concerns about inappropriate "nesting"
	Privacy laws may have to be enacted to deal with confidentiality issues
	May impact competitiveness of regional banks

Financial Action Task Force and BASEL Anti-Money Laundering Experts Group (AMLEG) Guidance

5.6 The guidance of international standard setters like the Basel Committee on Banking Supervision and the Financial Action Task Force (FATF) is proving to be of great utility in the global response to de-risking, particularly the search for solutions. The extent to which such guidance is delivered, respected and adhered to could prove to be an important solution or serve as a spine or platform for multiple solutions.

5.7 Over the last two years FATF has had to address the issue of "de-risking" particularly because the view that the mis-application of the FATF Recommendations (2012) call for application of a risk-based approach (RBA) to their requirement for robust customer due diligence standards to combat money laundering and countering the financing of terrorism, is heavily blamed as being a driver of de-risking. FATF recommends that countries should identify, assess and understand their money laundering and terrorist financing risks and allocate resources aimed at ensuring that the risks are mitigated effectively. It expressly recommends that based on the assessment countries should apply the RBA to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified[15].

5.8 There is some degree of divergence among national regulators and financial institutions on the issue of how RBA should be interpreted and applied. The inconsistent application of this recommendation appears to have become the most prominent drivers of the decline in CBRs and more specifically, the inappropriate "de-risking" of CBRs. The WB Survey reports that 95% of respondents (the highest percentage for any response) indicated that concerns about money laundering and terrorist financing risks were a top cause or driver for CBR withdrawals by large international banks. The WB Survey also noted that compliance lapses, - actual or alleged – by even one financial institution can have potential spill-over effects for other financial institutions, particularly in small jurisdictions[16].

5.9 FATF's then President Roger Wilkins has pointed out since October 2014 that "nothing in these standards require a rigid, blanket application of that requirement" and that what is most likely required is the "communication of more flexible regulatory practice and standards, and more refined and intelligent assessment of risk"[17]. The FATF also promised to provide more helpful guidance to banks and other financial institutions and it has done so in October 2014[18] , June 2015[19] and October 2015. Guidance has been provided on the risk-based approach[20].

5.10 FATF acts in the Caribbean through its regional style body CFATF which was established in 2009. CFATF is an organisation of states and territories which have agreed to implement common counter measures against money laundering. CFATF delivers valuable assistance and monitors compliance for all of the regional states and territories. It is well positioned to lead on this solution. However, it is under-resourced and will need the assistance of all regional stakeholders.

5.11 The BCBS's Anti-Money Laundering Experts Group (AMLEG) is also capable of providing very helpful guidance to banks on these issues[21]. The BCBS Committee on Payments and Markets Infrastructures (CPMI) in its Consultative Report on Correspondent Banking of October 2015 recommended that both FATF and AMLEG can be invited to provide guidance on:

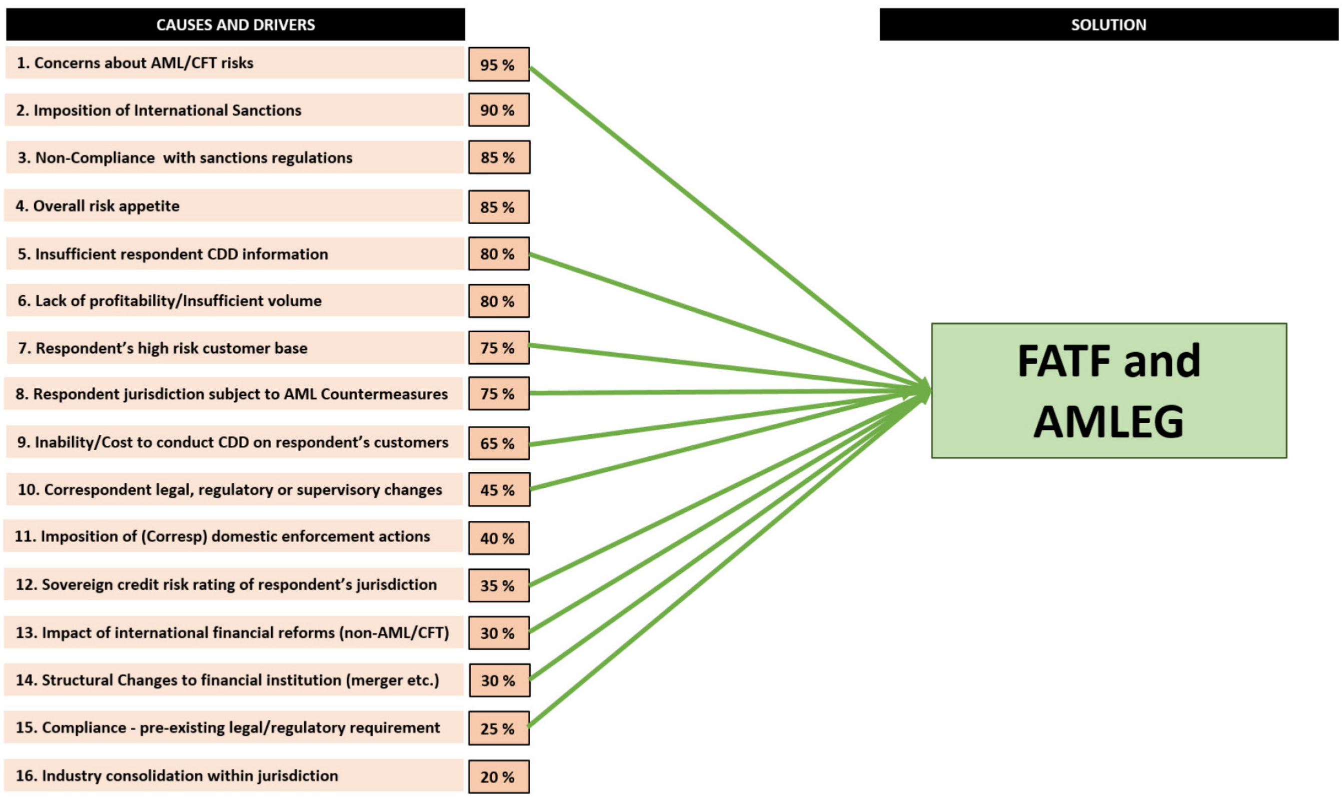
(i) additional clarity on due diligence recommendations for upstream banks, in particularly to what extent banks need to know their customers' customers ("KYCC");

(ii) further clarify data privacy concerns in the area of correspondent banking; and

(iii) detail to the extent possible, the type of data that information-sharing mechanisms could store and distribute in order to be a useful source of information.

5.12 CDB is well placed to provide funding for TA focused on strengthening the AML/CFT compliance framework in its BMCs at the national and institutional levels. At the regional level CDB is also able to support the work of the CFATF. With the FATF fourth round of national risk assessments underway under the supervision and coordination of CFATF, CDB's interventions can greatly enhance the Region's ability to identify, manage and mitigate money laundering/ financing terrorism (ML/FT) risks to remain compliant and increase attractiveness to and reduce compliance costs for correspondent banks.

5.13 A related solution is for all countries to publish their national AML/CFT risk assessments. The US has published their 2015 national risk assessments for both ML and FT[22].

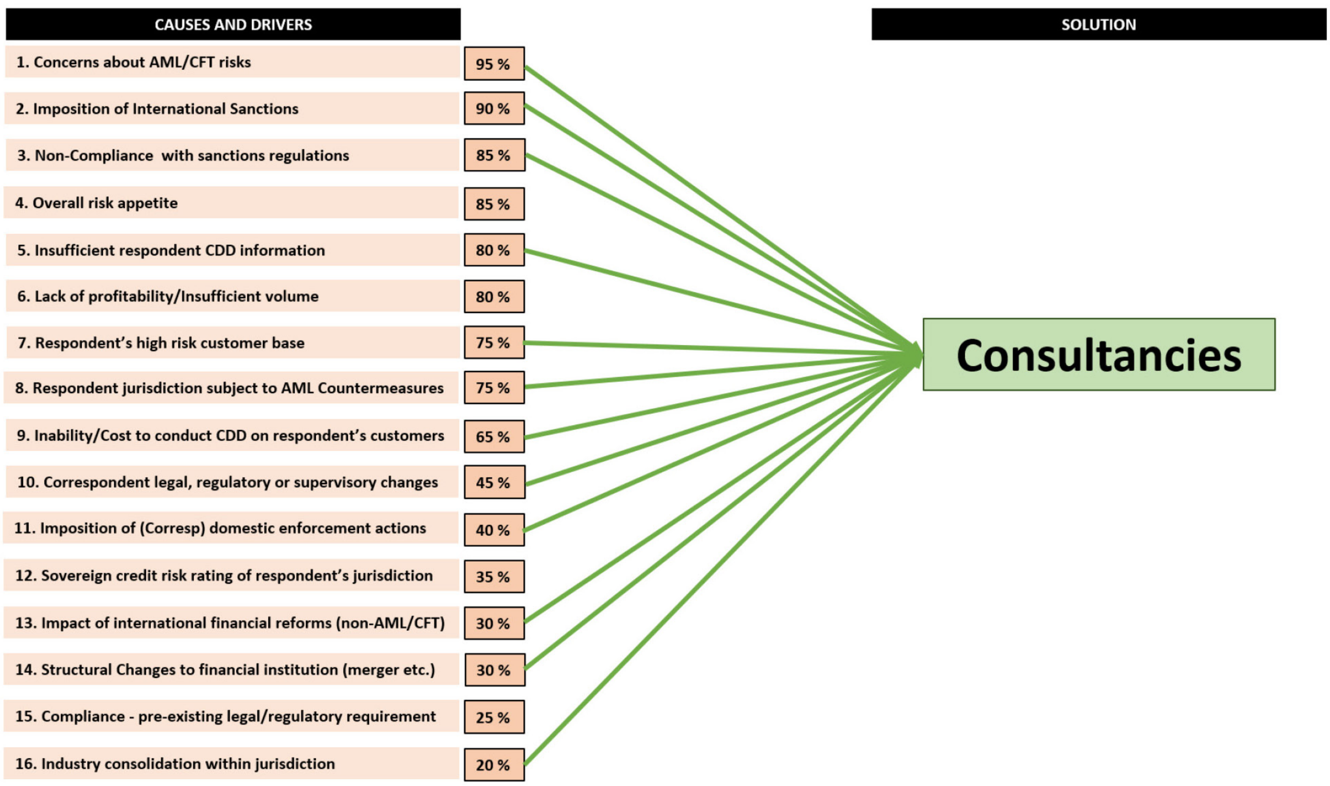


PROS	CONS
Credible sources of clear guidance will encourage adoption and harmonization of risk-based rules	FATF and AMLEG timetables may not match the urgency of our regional, national and institutional stakeholders
Very helpful and broad application will enhance and level the global playing field	CFATF is not sufficiently resourced to deliver as effectively as it could but can be supported to do so

Consultancies on Operational and Technical Profile and Shortcomings

5.14 This is likely to be a very helpful way to have an insight into what is driving the withdrawals of CBRs and also respond in a manner that takes account of the peculiar requirements of e.g. US correspondent banks and their examiners.

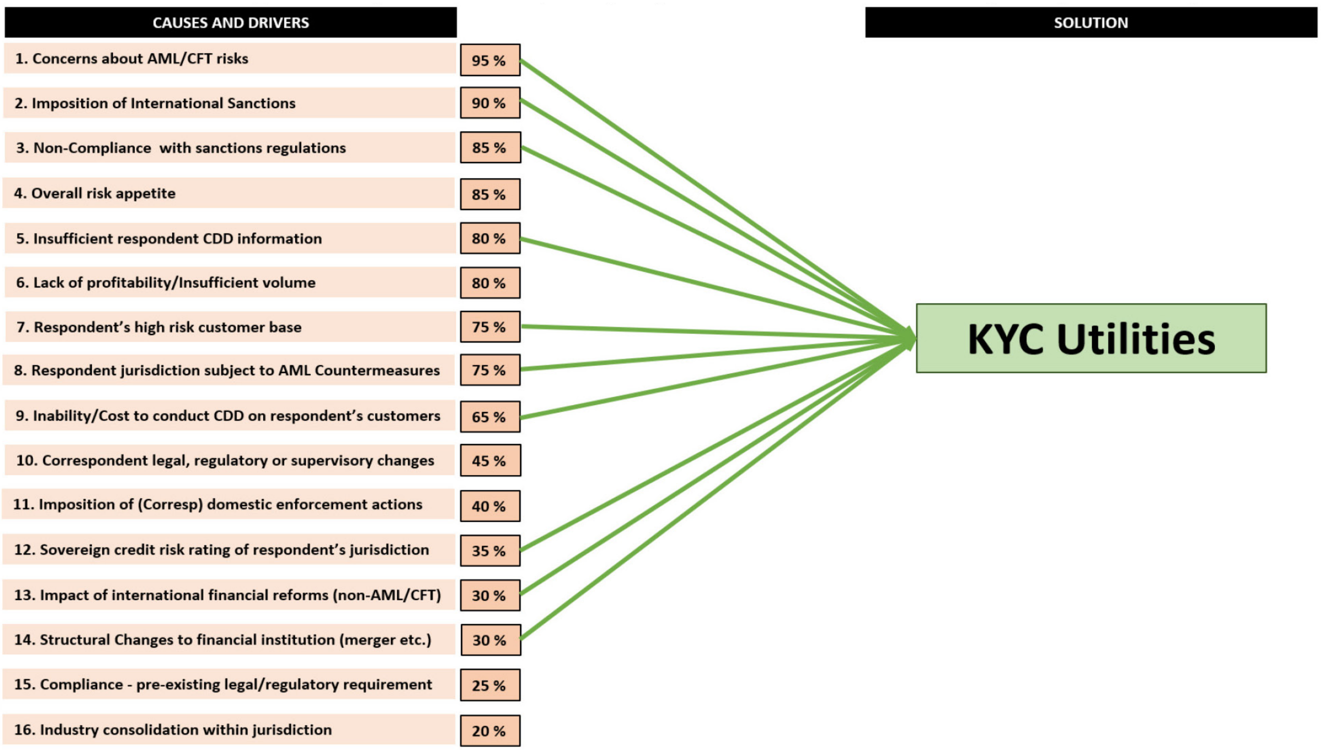
5.15 These kind of consultancies can be undertaken by respected retired bank examiners and other financial regulators who “know their own banking and regulatory system inside out”. These consultancies can focus on gaps and shortcomings in the operational and technical profiles of regional respondent banks in the form of a diagnostic assessment but also to assist their planning going forward on what it would take to retain current CBRs or recover lost CBRs. Many US-based, particularly Washington DC-based consultancy firms and top-tier law firms offer these kinds of services.[23]



PROS	CONS
May help to provide key insights to respondent banks	Limited utility of ex ante findings for respondents who have lost CBRs although will be helpful with planning
Perhaps the best way to conduct diagnostic sufficient enable bank to develop strategy to cope with loss of CBR and to explore options	Cost – may be prohibitive for small banks

Know –Your-Customer Utilities (KYC Utilities)

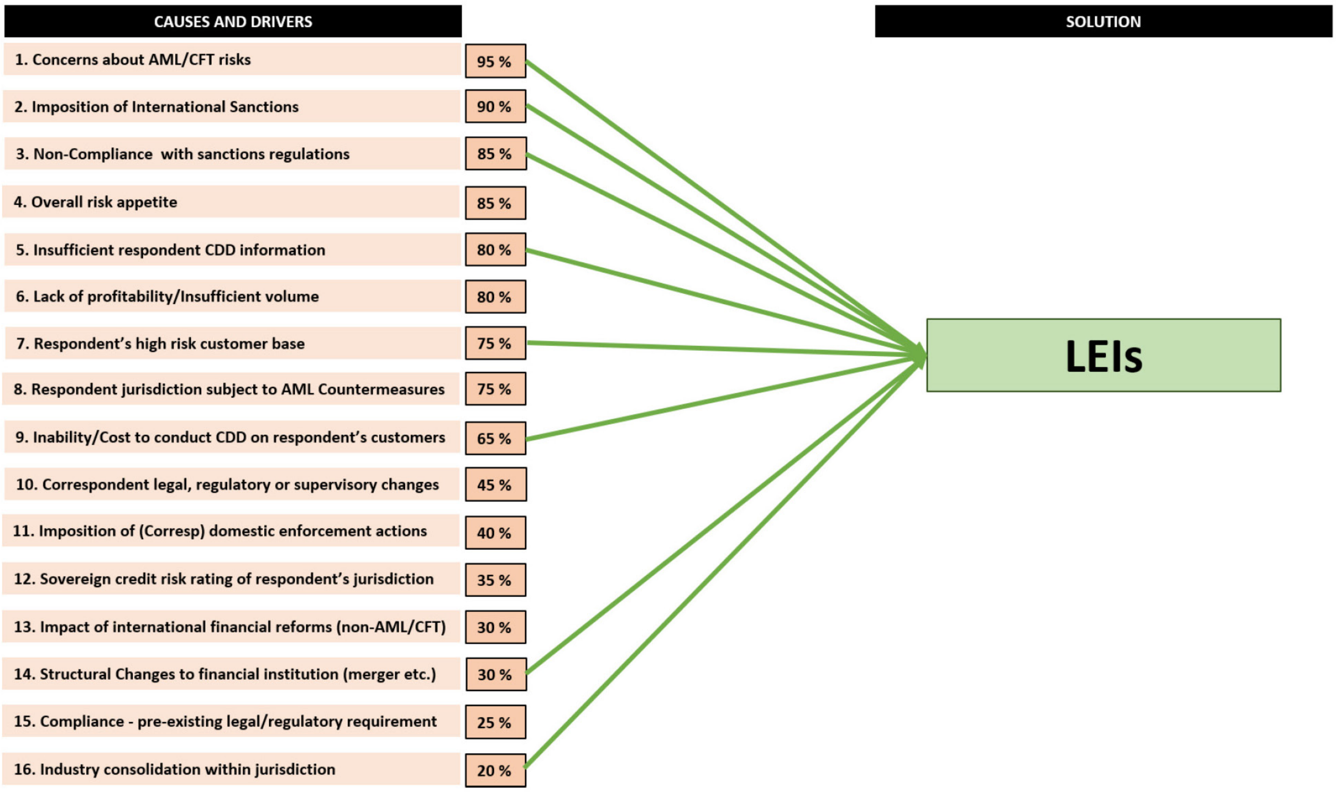
5.16 KYC Utilities are facilities are electronic repositories for respondent banks to store and update their customer information which correspondent banks can then access to conduct their due diligence. Respondent banks control access and thus can make their information available only to designated correspondent banks with whom they already have (as part of ongoing due diligence) or hope to have CBRs KYC Utilities can significantly reduce time, cost, duplication of effort and complexity for both parties.[24]



PROS	CONS
Speed - Easy access to helpful due diligence information stored in a single repository	Lack of standardization of required data may delay use
Initial information can be updated by respondent banks seamlessly and in an anticipatory basis	Lack of an independent standard that outlines the requisite systems and controls to ensure accurate data (e.g. external accreditation process to test compliance with the standard)
Promote standardisation – i.e. can lead to development of standardized template (along Wolfsberg)	Some countries may be required to enact or amend privacy laws
Control - Respondent banks as info providers retain control over data	
Independence - Respondent banks determine which correspondent banks see data	
Cost - Reduces time and costs of repeating data submissions – less data to be exchanged	
Accuracy and consistency of data can be improved	

Legal Entity Identifiers

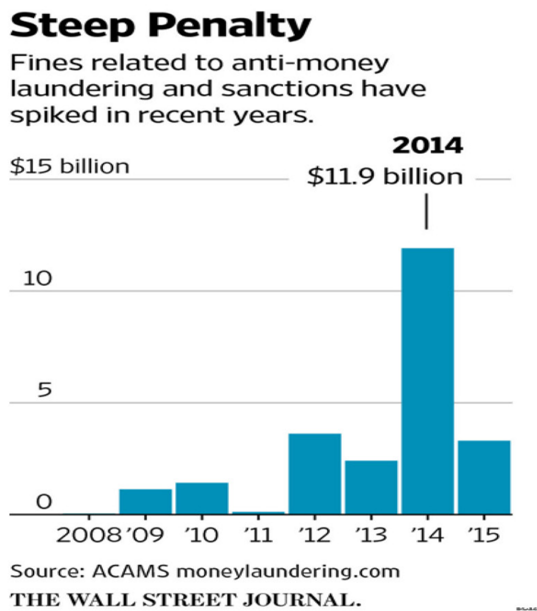
5.17 A Legal Entity Identifier (LEI) is a unique 20-character, alphanumeric code that can be used to identify distinct legal entities that engage in financial transactions so that each firm can be traced and information made widely available. It is effectively a tool to assist with identification and mitigation of financial risk by increasing immediate access to credible knowledge of transactional counterparties. LEIs can be embedded in the knowledge data banks available through KYC Utilities. Consideration can be given to imposing mandatory use of LEIs.



PROS	CONS
Easily adaptable to enhance KYCs for CBRs	Cannot substitute for AML/CFT due diligence
Can integrate originator and beneficiary information in wire transfer payment messages for FATF compliance	Does not apply to individuals (natural persons) and thus cannot identify them as beneficial owners
Can be used to track specific entity's transactions	May be impacted by data protection laws
Can enable faster even automatic screening and provide unambiguous counterparty identity	Not yet included in payment messages like Business Identifier Codes have been
Utility as a globally acceptable standard and thus can work with KYC Utilities and info sharing mechanisms	Current payment messages cover both corporate bodies and natural persons using BIC without LEIs

Insurance

5.18 Insurance as a tool can be used to transfer and mitigate some key risks related to this issue, particularly, the risk of enforcement actions leading to or accelerating the decline in CBRs. Fines related to AML/CFT levied against banks spiked in 2014 to $11.9 billion dollars so the use of insurance requires careful thinking and planning to ensure that it is workable and practical.

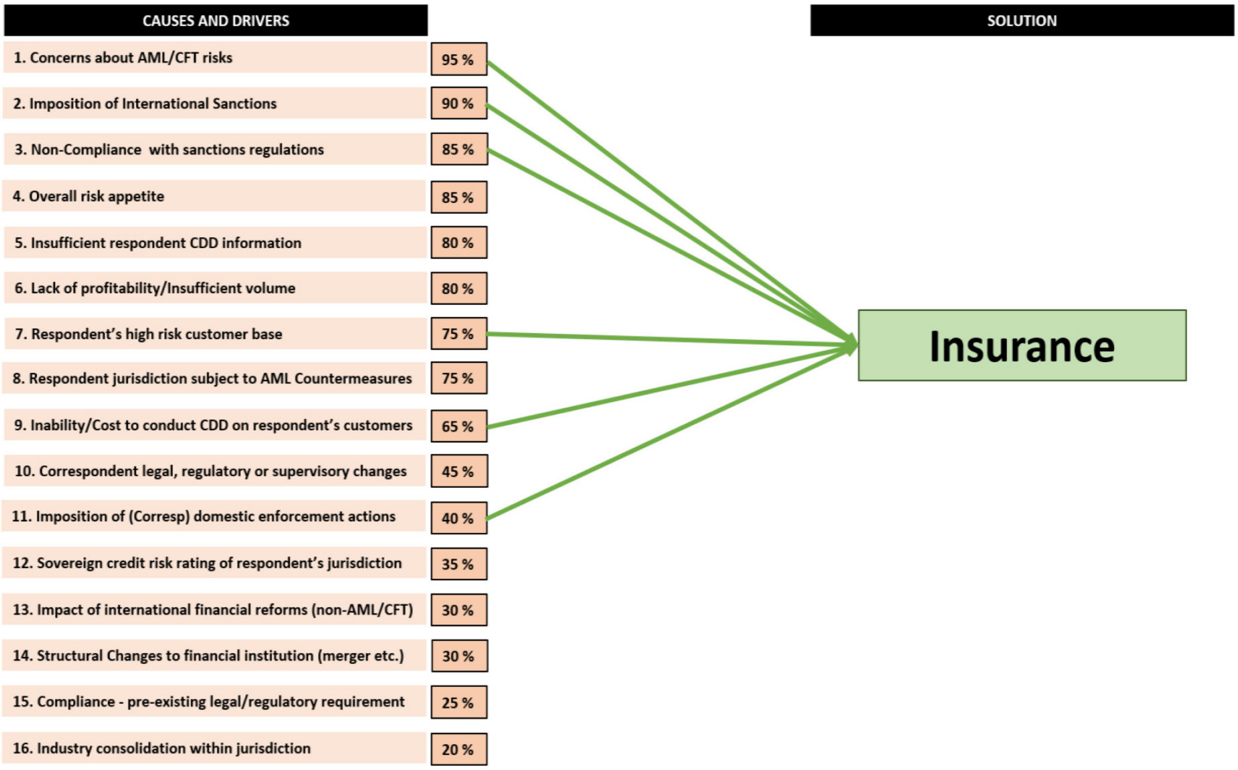


5.19 Cost of the insurance will be a key issue. Appropriate pricing and financial assistance with premiums will be needed to support the initiative. Stakeholders will need to ensure that the correct insurable events are identified (e.g. enforcement related events like fines and other sanctions and that they identify the appropriate insurer (whether each regional bank individually, as a pool of regional banks or a single regional bank acting as a hub or agent of other banks) and provider. Pooling may reduce policy premium costs.

5.20 The scope of such insurance policies would primarily cover insurable events based on determinations made by consulting with financial regulators or other enforcement bodies (for example the Department of Justice in the United States) and include: AML/CFT compliance enforcement sanctions including monetary penalties and fines; adverse regulatory directives; regulatory investigations; and settlements whether negotiated before or after any final judicial or administrative determinations. Institutional legal defense costs can also be covered by these policies in the same way that modern directors and officers insurance policies provide coverage for defense costs associated with regulatory investigations and sanctions.

5.21 Consideration must also be given to whether and to what extent an insurance arrangement may create moral hazard and encourage complacency among the insured banks. This risk will be mitigated by many factors including: the structuring of the arrangement to ensure that there is never a need to have to invoke the insurance; the insurer's due diligence on the insured; continued diligence by correspondent banks; and regional regulators of insured banks continuing to ensure that those banks maintain the highest standards of compliance with AML/CFT standards.

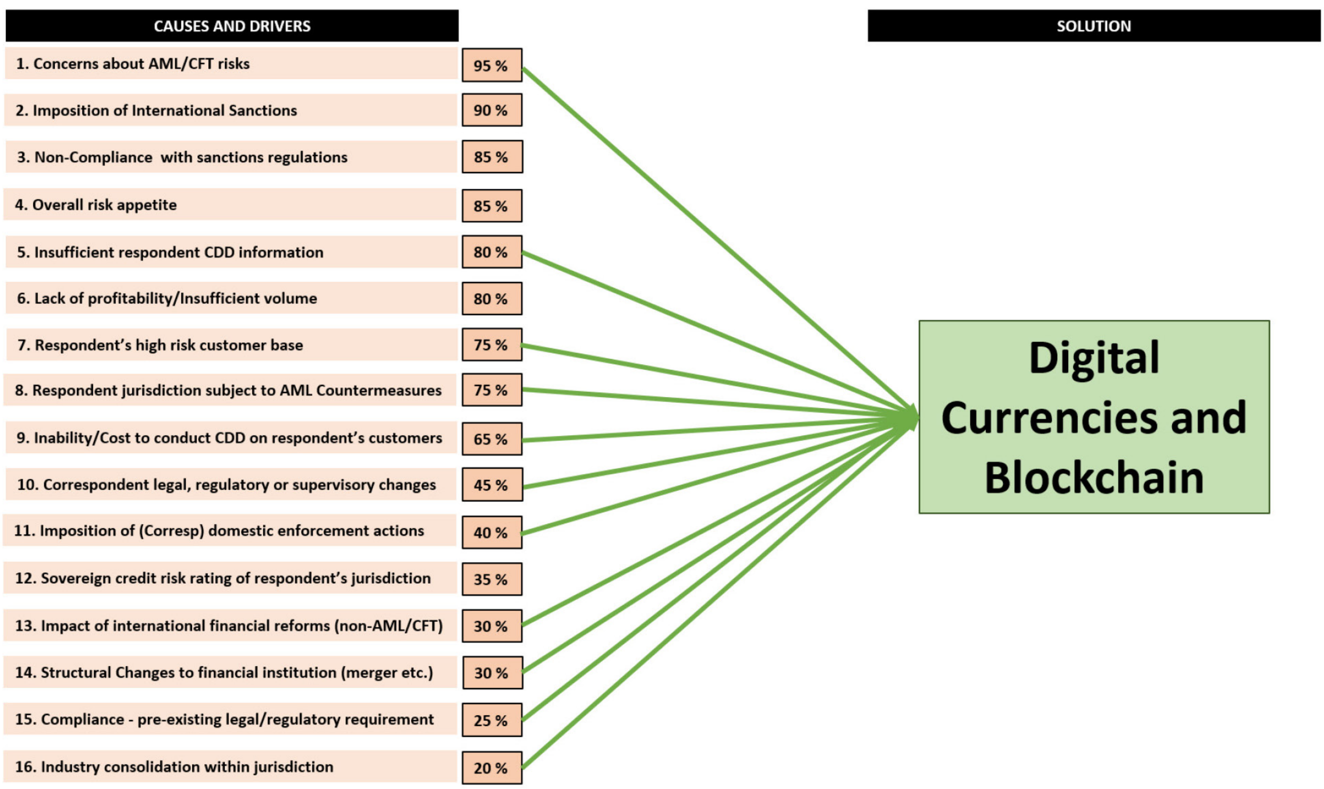
5.22 Impact of some policy changes driven by enforcement actions may also be mitigated by insurance. At least four of twenty banks surveyed by WB noted that they effected a foreign correspondent policy change in order to comply with supervisory directives or enforcement actions brought against them.[25]



PROS	CONS
Event driven which may narrow the scope of coverage e.g. only to an AML enforcement related event	Event driven – actual event (e.g. enforcement event) may not be covered in the policy – difficult to anticipate every likely event and regulatory enforcement response
Model is not new and thus easy to negotiate/broker - precedents already exist with Directors and Officers and liability insurance for errors and omissions	Costs may be prohibitive subject to a regional subsidy or contribution from governments of the region
Regional effort to fund premiums is possible	Some events e.g. entry into a Deferred Prosecution Agreement (DPA) may not necessarily result in immediate loss to bank – contingent liability to pay a fine can be difficult to predict
	Will have to include legal costs which can be heavy and ongoing for the life of the sanction or DPA
	Structure could be tricky either a bank by bank basis or an appropriate single regional vehicle will have to be created/used which may be difficult to achieve
	Moral hazard –complacency may set in regionally among insured banks and their regulators

Block Chain and Digital Currencies

5.23 Bitcoin is a digital currency that exists on a public network and can be used as an alternative payment method to traditional wire transfers. Each bitcoin user owns their bitcoin and a wallet that is used to make and receive payments. The Bitcoin blockchain protocol is an interconnected network of computers that manage a public log (ledger) of all bitcoin transactions between various bitcoin wallets. Transactions in the blockchain are irrevocable so the blockchain stores and tracks all of the background supporting data awaiting approval that can be used to verify the transaction also known as the 'proof of work'. With each approval and validation of the data a new block is created and added to the blockchain. Each block carries data that establishes a sequential link with the previous block. Blockchain can be used for other forms of property other than bitcoin.



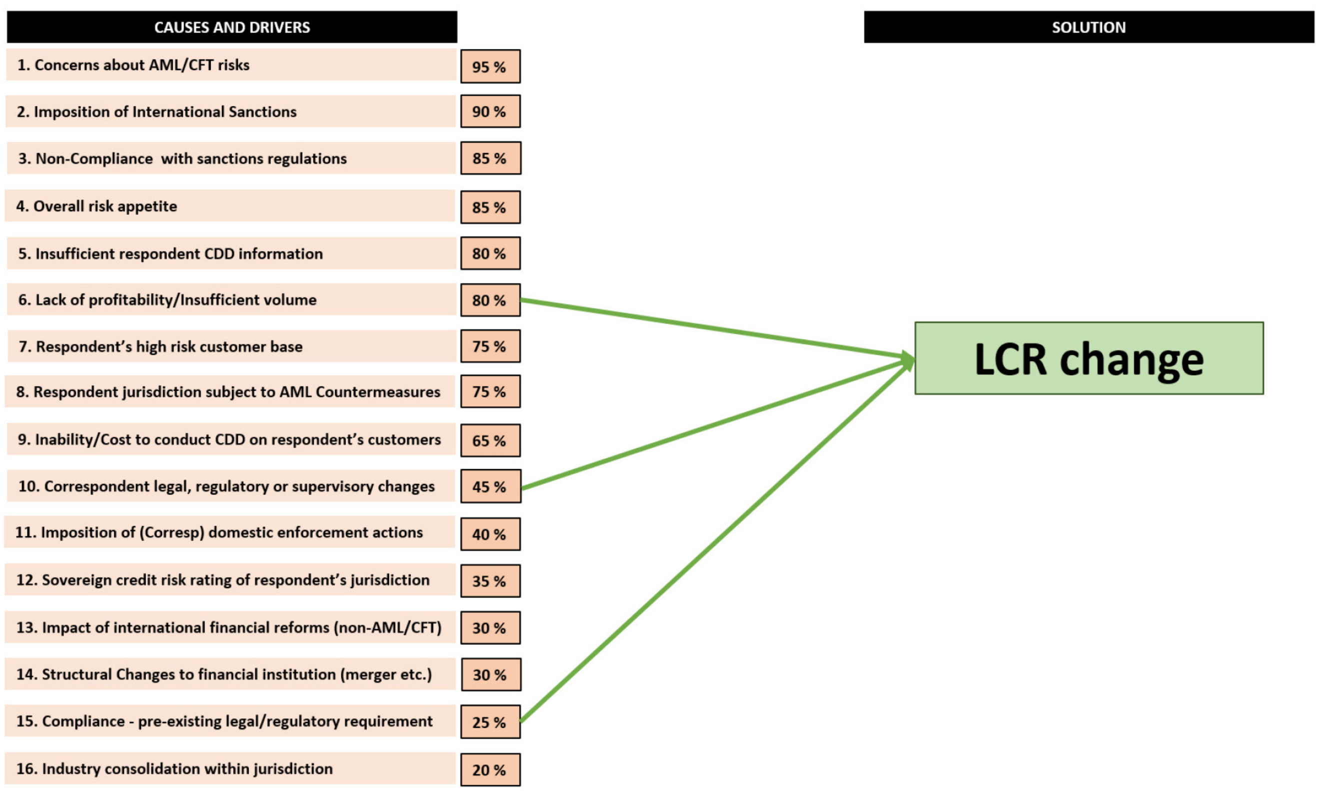
PROS	CONS
Publicly available title history for bitcoins and property	Perfect for criminal activity but will be traceable
Reduces cost - enables peer to peer funds transfers without intermediaries and any clearing agent	Will require same type of due diligence as accounts
Every transaction good or bad is traceable	Online speed and complexities will be hard to police
Can be subjected to due diligence and regulated	Makes sanctions and counterparty risk more complex
Can be used for domestic and international payments for products and services	

Lobbying for an amendment to the Liquidity Coverage Ratio

5.24 The 'lack of profitability' driver is exacerbated by the impact of the Basel III Liquidity Coverage Ratio (LCR). LCR is a standard that was designed to increase banks' liquidity buffers in direct response to the role liquidity played in causing or exacerbating the 2007-09 global financial crisis. LCR will require banks to hold a buffer of high quality liquid assets (HQLA) sufficient to withstand a 30 days stressed funding scenario which national regulators may vary. Banks will be required to hold 25% of HQLA for deposits held as necessary for operational transactional purposes and classified as 'operational deposits' and 40% of HQLA for other non-financial unsecured wholesale corporate deposits classified as 'non-operational' deposits. Each type of deposit is assigned an expected outflow factor.[26]

5.25 A key concern is that the LCR is expected to be fully implemented by 2019 but the federal financial regulators in the US have implemented a 'modified LCR' which requires implementation by January 1, 2017. In effect the LCR appears to increase the cost of holding CBR deposits and may eliminate any incentive for a correspondent bank to undertake a CBR.[27]

5.26 US-based correspondent banks have already begun to pass on the cost by increasing significantly, the pricing to keep out certain types of short-term (e.g. overnight) deposits and to offset the cost of carrying such deposits that attract a 100% outflow rate factor. Regional Central Banks and other national financial regulators are well positioned to lead a coordinated effort to lobby the BCBS and relevant national regulators, particularly in the USA to address this issue in a manner that balances the need for adequate liquidity coverage and support the creation of sound CBRs.[28]

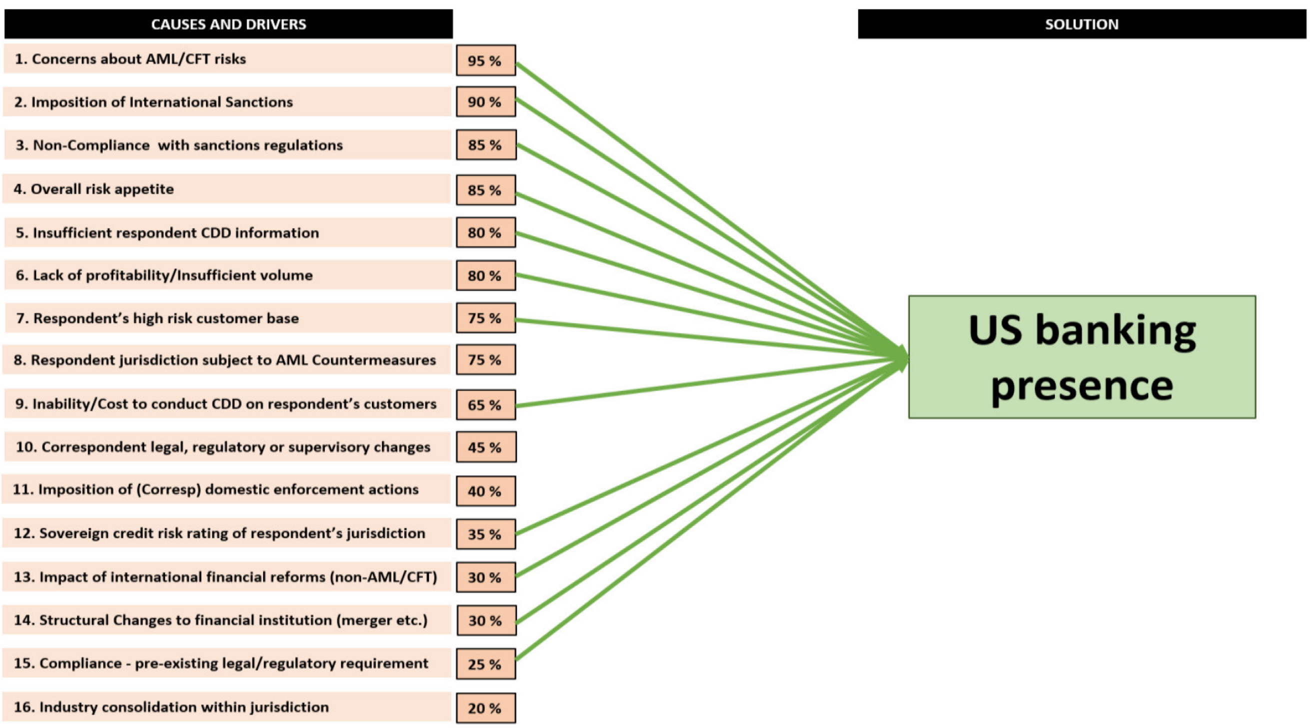


PROS	CONS
Will make CBR's profitable for correspondent banks	Could be difficult from the perspective of time, costs and rationale because the LCR deals with a justifiably major problem from the 2007-09 financial crisis, the effects of which are still being felt today.

US-based presence through a Caribbean-owned bank, clearing institution or agency

5.27 Another possible solution is the establishment in the US of a Caribbean-based presence through a Caribbean-owned bank, clearing institution, agency or representative office as an entity with or through which regional institutions can have CBRs.[29]

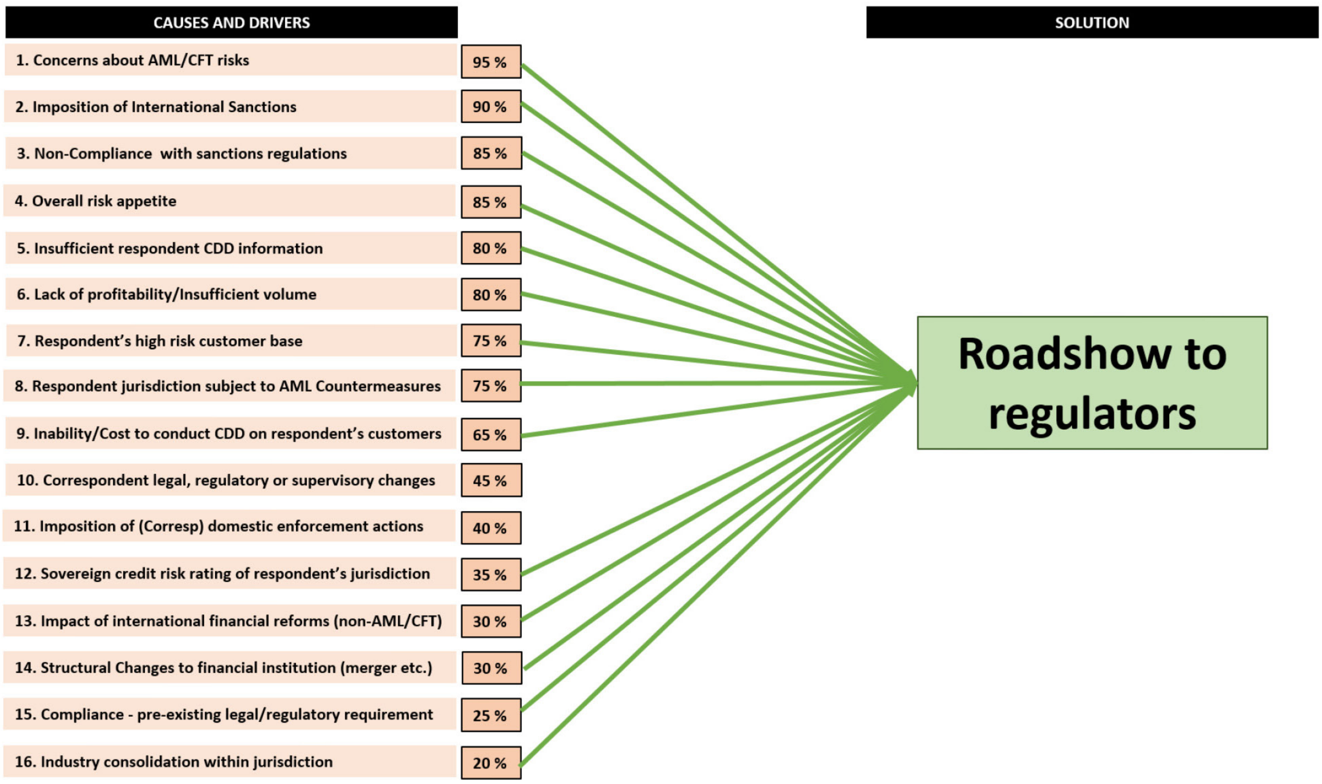
5.28 The operational burden to establish such an institution, particularly given the high barrier to entry to conduct business in highly regulated financial markets like New York, would require careful planning and investigation. Among other things, the registration and licensing costs, time and operational risks associated with establishing such an institution could prove to be prohibitive. A strong sustainable pipeline of correspondent banking traffic is likely to prove attractive to such an institution but its success will always be subject to the variety and costs of the risks involved. Such an institution may be created or acquired but will not be immune from the same compliance and regulatory enforcement risks currently faced by US-based correspondent banks.



PROS	CONS
Provide a US Federal Reserve approved US dollar clearing account facility for Caribbean correspondent banking transactions	Time - may take 3-5 years for initial approval and longer time to establish
	Costly
	Regulatory oversight - Bank, Agency or Office may still be subjected to heavy regulatory scrutiny
	If a Caribbean based entity will have to establish comprehensive consolidated supervision to US standards which is not likely
	Capital will need to be raised
	Enforcement – risk of incurrence of enforcement penalty for breaching US AML regulations will not diminish but may instead be enhanced if jurisdictions are considered to be "high risk"

Road shows and meetings to lobby US, Canadian and UK regulators

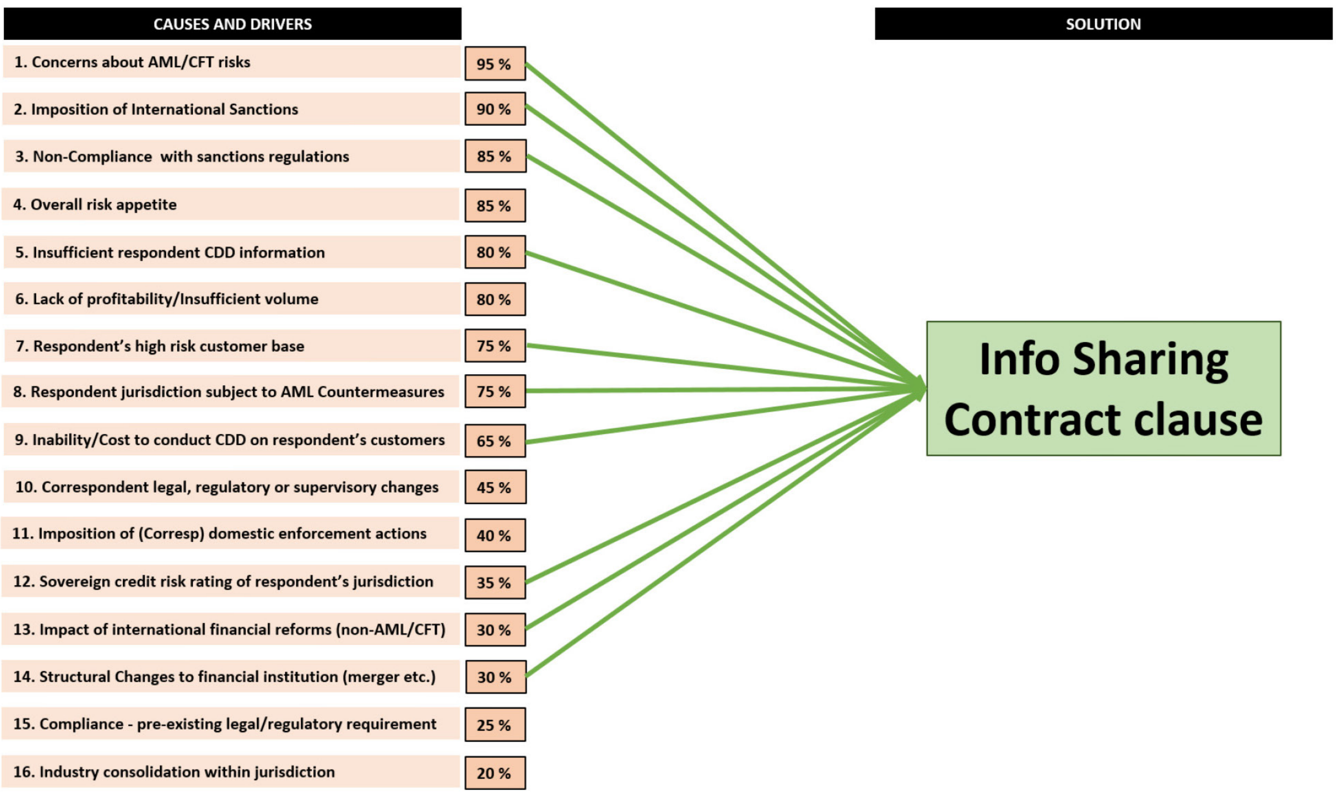
5.29 Targeted roadshows by Caribbean stakeholders including direct engagements by national stakeholders (e.g. governments) or regional stakeholders (e.g. CARICOM) with the US federal regulators have already commenced. These opportunities must be continued proactively because they can work well to reduce information asymmetries, increase visibility and top-down engagement.



PROS	CONS
Reduce information asymmetries	Requires follow up to avoid being seen as a photo-op.
Increases visibility among key decision-makers	Limited impact. Promises are often not kept.
Can create top-down engagement	Regulatory priorities often include the protection of national champions
	Regulators tend to err on the side of caution and are loathe to roll-back regulation
	Regulators may be able to tell banks not to de-risk but will not be able to direct banks not to sever on the basis of appropriate de-risking
	US regulators have noted that severance of a CBR after an appropriate case-by-case risk assessment is not de-risking

Information sharing contract clause

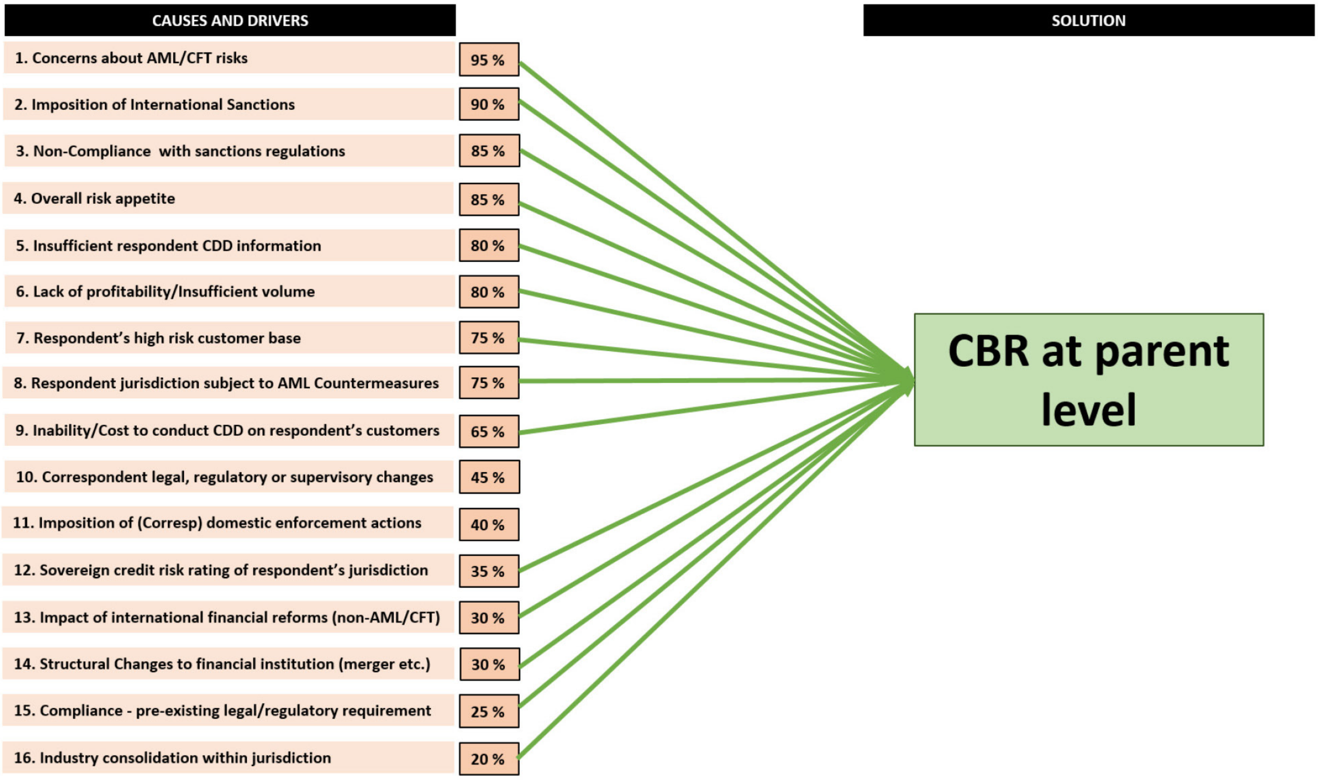
5.30 This solution promotes the broader use of specific contractual provisions intended to facilitate easier and faster information sharing between respondent and correspondent banks. Such contractual provisions would enable customers to authorise their banks to release promptly relevant information related to AML/CFT due diligence and for compliance purposes, to the correspondent banks and other information databases/hubs and sharing mechanism, as discussed above.



PROS	CONS
Tried and tested legal mechanism	Customers may refuse or seek carve-outs or limits on scope of disclosures if statute allows them to do so

Correspondent Banking Relationships at Parent Level

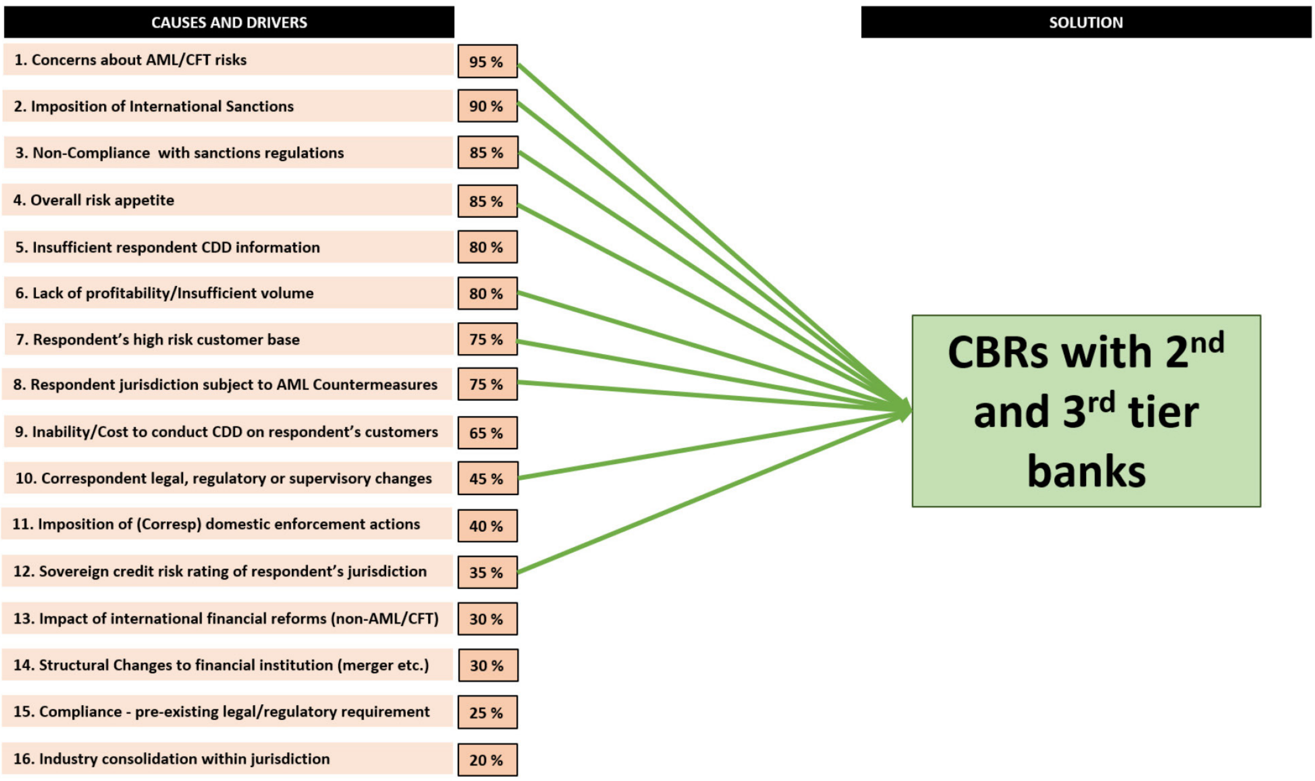
5.31 CBRs can be effected at the parent level to increase volume and also to reduce the number of risk-related barriers that may arise if the CBR is effected at the subsidiary level.



PROS	CONS
Very workable and easy to establish - precedents already exist	Parent can become a larger target for enforcement action and will be challenged to ensure that all subs are covered in a cost-efficient way
	Cost efficiency
	Parent may be a financial institution but not a bank which may have potential regulatory impacts for supervision of the parent
	Location of the parent must be a well regulated, medium to low risk, compliant jurisdiction
	Parent's compliance track record must be impeccable

Correspondent Banking Relationships with 2nd and 3rd Tier Foreign Correspondent Banks

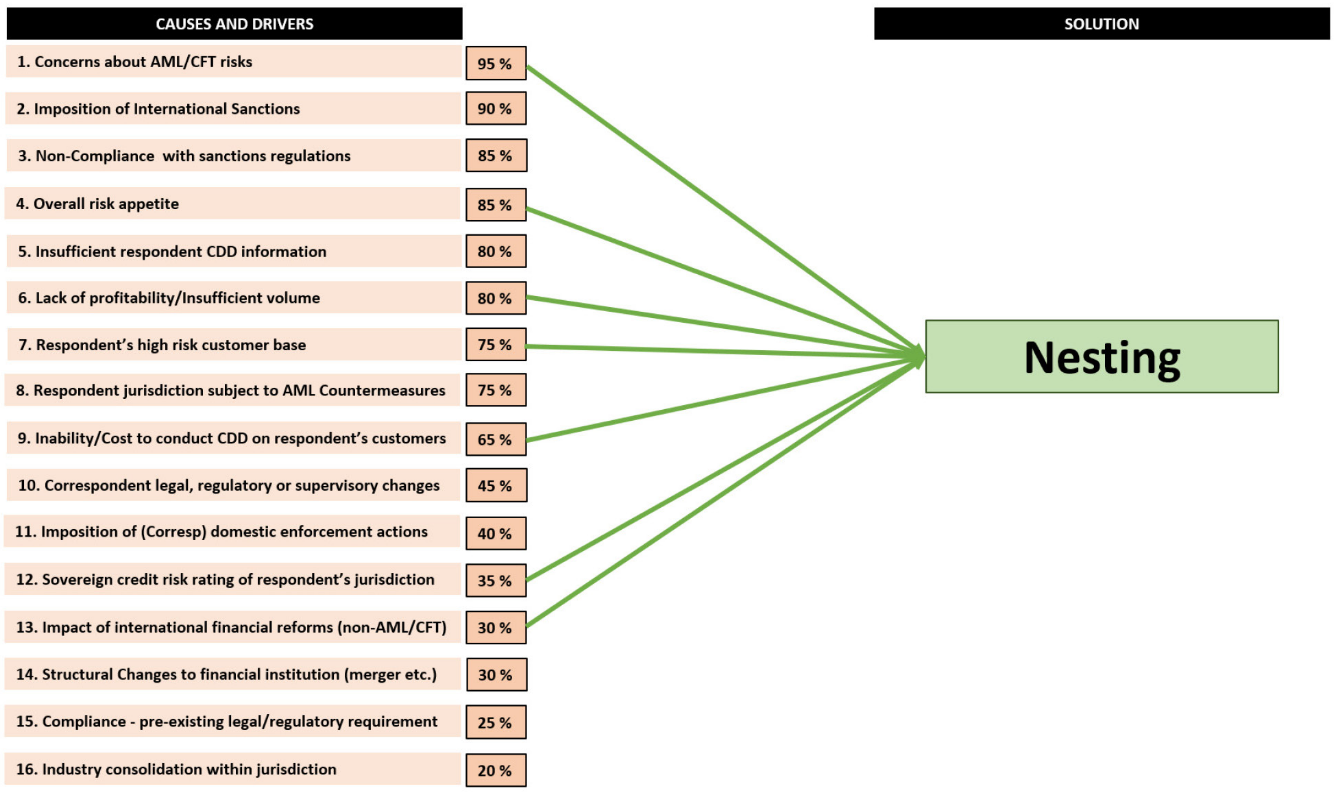
5.32 Access to the US financial system through second and third-tier foreign banks from the US is another solution to be considered. Outside of the traditional large US banks, some new correspondent banks, may be very is interested in offering such services to the Region's respondent banks and at least one such bank has already indicated its willingness to provide such a service.[30]



PROS	CONS
Precedents exist	Risk having a race to the bottom
	Cost – desperation may drive up fees

Nested Correspondent Banking Relationships

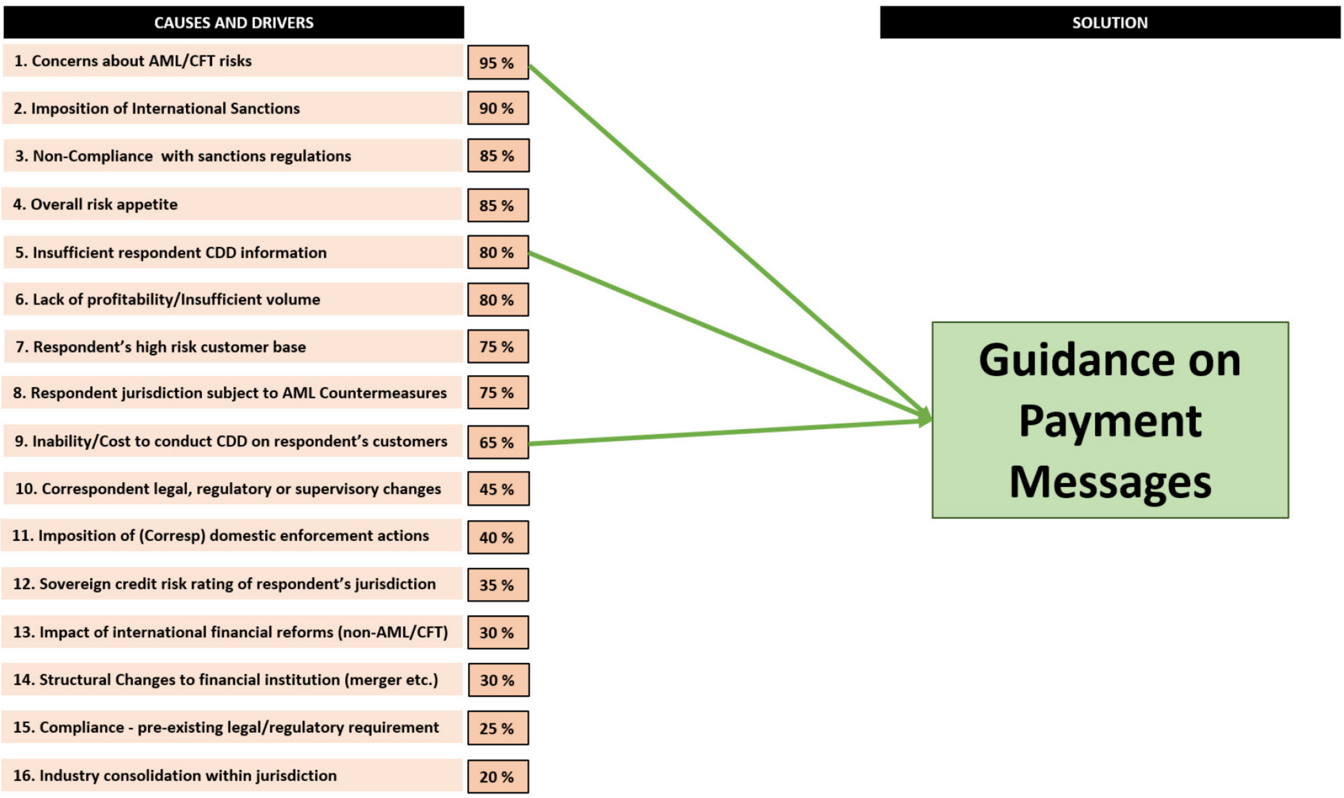
5.33 Nesting of CBRs occurs in the context of "downstream' CBRs when a respondent bank itself provides correspondent banking services to other banks domiciled inside or outside of their home country to facilitate international financial services on behalf of the clients of the downstream correspondent bank. In these circumstances the primary or "upstream" correspondent bank must conduct due diligence on its respondent bank, the nesting correspondent bank and its downstream services including its AML/CFT risk profile and its AML/CFT controls. The same stringent KYC standards will have to be met with detailed Customer Due Diligence (CDD) being conducted on each nested respondent bank. Nesting typically requires enhanced due diligence and high levels of internal approvals of the CBR by the management of the upstream or primary correspondent bank.



PROS	CONS
Tested and workable particularly through 2nd and 3rd tier correspondent banks	Considered high risk and attracts enhanced due diligence
Can assist with volume of traffic and profitability	Can create a bigger target for regulators of the primary correspondent bank

Guidance on Payment Messages

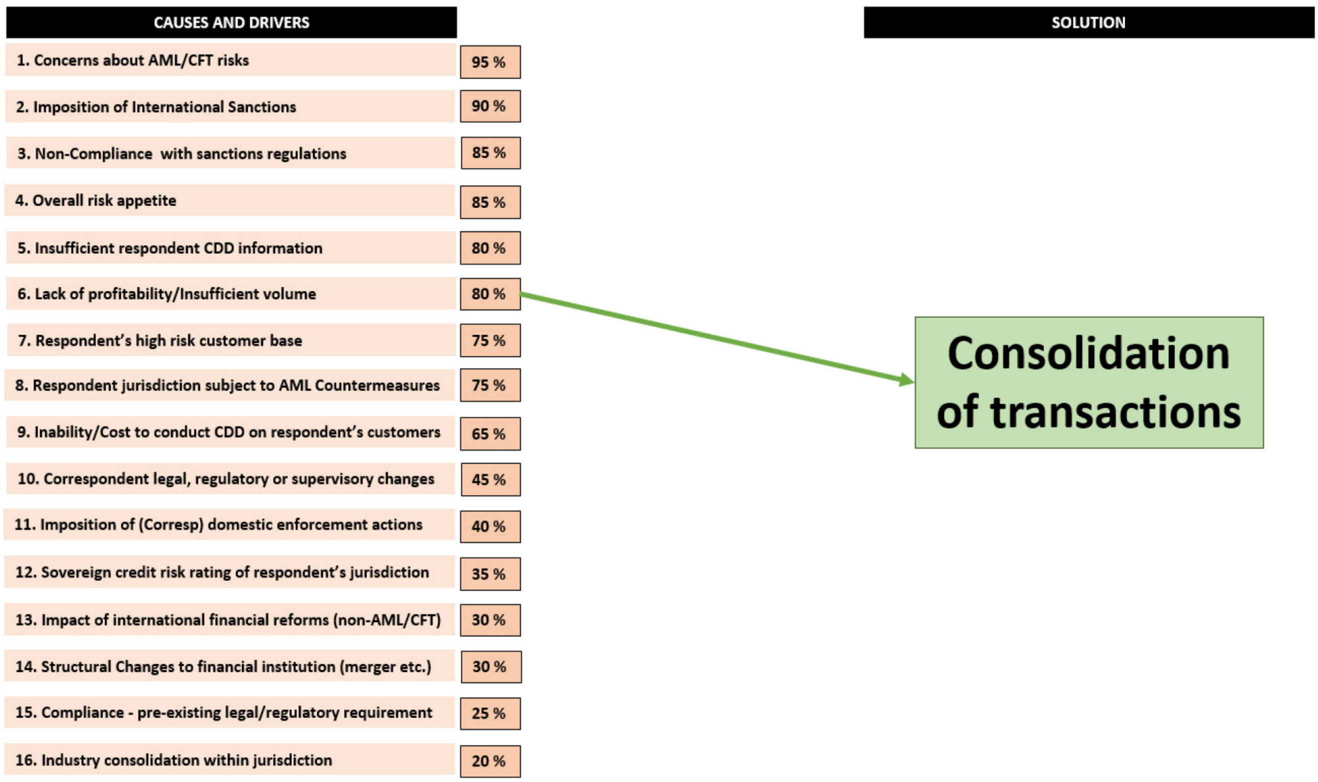
5.34 This solution refers to guidance on how payment messages exchanged via SWIFT among correspondent and respondent banks can be enhanced to ensure that all key information requisite for AML/CFT compliance is supplied in payment messages. The Bank for International Systems (BIS) Committee on Payment and Market Infrastructures (CPMI) has relatively recently issued a Consultative Report on Correspondent Banking in October 2015 (CPMI Report).[31] The CPMI Report helpfully reviews the advantages and dis-advantages of certain technical measures related to payment systems. These measures are: (a) KYC Utilities; (b) LEIs; (c) information-sharing mechanisms; and (d) improvements in payment messages.



PROS	CONS
Can greatly enhance information reliability on payment messages and reduce concerns about laundering through wire transfers	

Consolidation of National Transactional Traffic Through A Few Major Correspondent Banks

5.35 Consolidation of transactional traffic could take place at the national level or at the regional level through the Centralised Transactions Hub solution option (above). Consolidation of transactional traffic at the national level is a short to medium term solution. This envisages that all or most of the banks in a particular country could use one or only a few correspondent banks. This will increase the volume for that correspondent bank(s) and the reduced costs (of providing the service to many banks instead of one bank) could be shared among those banks.



PROS	CONS
Can reduce CBR costs burden on small banks	Traffic may still be regarded as high-risk by foreign correspondent banks thus creating a bigger target for de-risking
Could produce sufficient volume and profitable traffic to a large foreign correspondent bank	"high risk" actions of a single bank could taint the whole stream of traffic and put pressure on the CBR
Can be done in short to medium term	Risk of classification as inappropriate "nesting"

Consolidation in the Regional Banking Industry

5.36 Consolidation of banks in the regional banking industry is a medium to long-term solution likely to be driven by both market and non-market considerations including the traditional drivers like profitability, footprint, synergies, size, scale as well as AML/CFT and other compliance-related complexity and costs.

CAUSES AND DRIVERS	
1. Concerns about AML/CFT risks	95 %
2. Imposition of International Sanctions	90 %
3. Non-Compliance with sanctions regulations	85 %
4. Overall risk appetite	85 %
5. Insufficient respondent CDD information	80 %
6. Lack of profitability/Insufficient volume	80 %
7. Respondent's high risk customer base	75 %
8. Respondent jurisdiction subject to AML Countermeasures	75 %
9. Inability/Cost to conduct CDD on respondent's customers	65 %
10. Correspondent legal, regulatory or supervisory changes	45 %
11. Imposition of (Corresp) domestic enforcement actions	40 %
12. Sovereign credit risk rating of respondent's jurisdiction	35 %
13. Impact of international financial reforms (non-AML/CFT)	30 %
14. Structural Changes to financial institution (merger etc.)	30 %
15. Compliance - pre-existing legal/regulatory requirement	25 %
16. Industry consolidation within jurisdiction	20 %

SOLUTION

Consolidation of Banks

PROS	CONS
Can reduce compliance costs burden on small banks	Not likely to occur quickly and more likely to be driven by a single major event (e.g. crisis) or years of cumulative and strategic decisions
	Likely to increase concentration of traffic which may be regarded as high-risk by foreign correspondent banks thus creating a bigger target for de-risking

Uniform Exit Guidance and Notification to Respondent Banks

5.37 This is more of a mitigant than a solution. Part of the problem outlined above is that today respondent banks are being blindsided; CBRs are being closed without any notice or reasons provided to the respondent bank. Yet, as mentioned above, among the many policies, procedures and processes that the US correspondent banks are required to have in place is "established criteria for closing the foreign correspondent financial institution account".[32] In the circumstances it is relatively easy to establish protocols on notification periods of a fixed number of months and uniform guidance including a template for closing CBRs which both the correspondent and respondent can reliably use. Other related suggestions include placing additional restrictions including credit and other limit, using trial periods, and sharing more information about the reasons for the withdrawals/severance to provide greater transparency and allow respondent banks to organise their affairs to find substitutes CBRs.

CAUSES AND DRIVERS	
1. Concerns about AML/CFT risks	95 %
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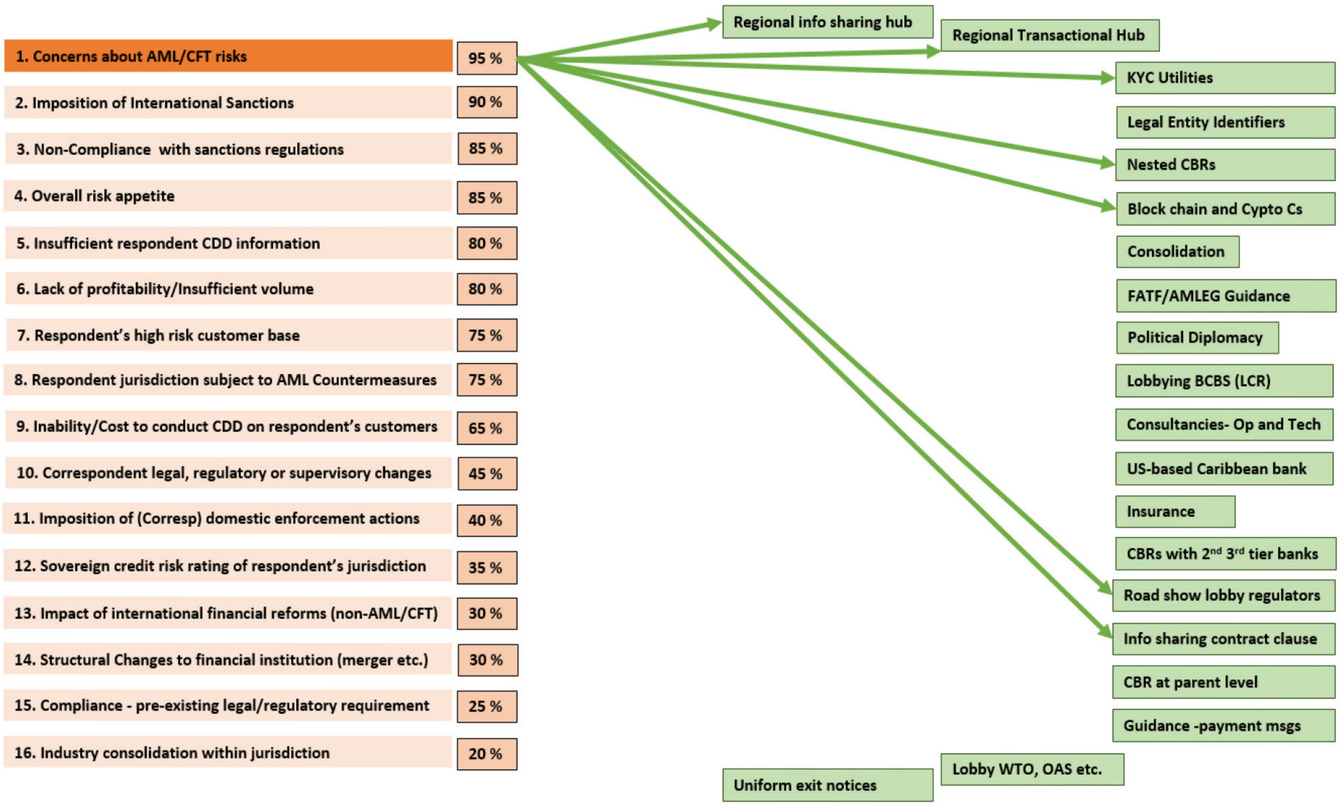
MITIGANT
Exit Guidance

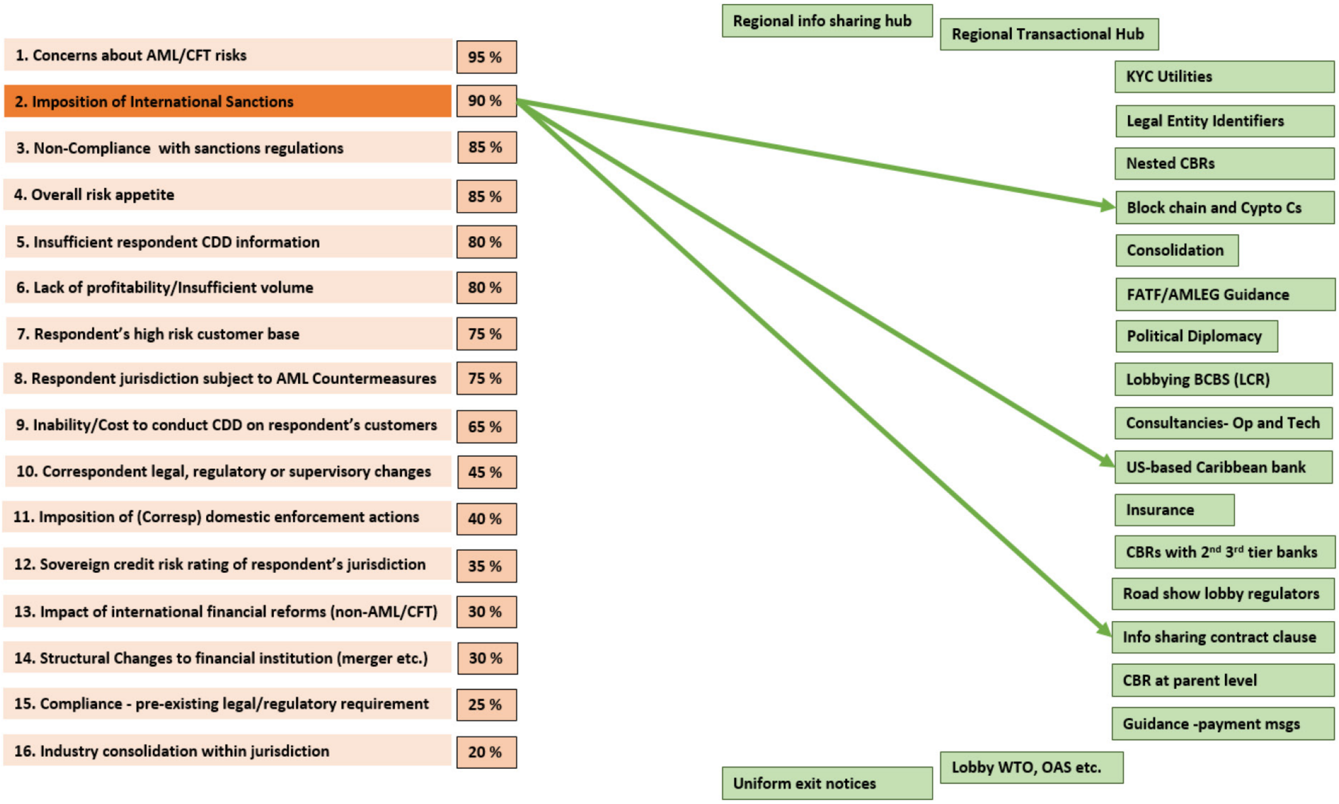
LINKING SPECIFIC CAUSES AND DRIVERS TO POTENTIAL SOLUTIONS

This section uses simplified graphics to illustrate how each stakeholders can potentially link specific causes that affect them to one or more potential solutions.

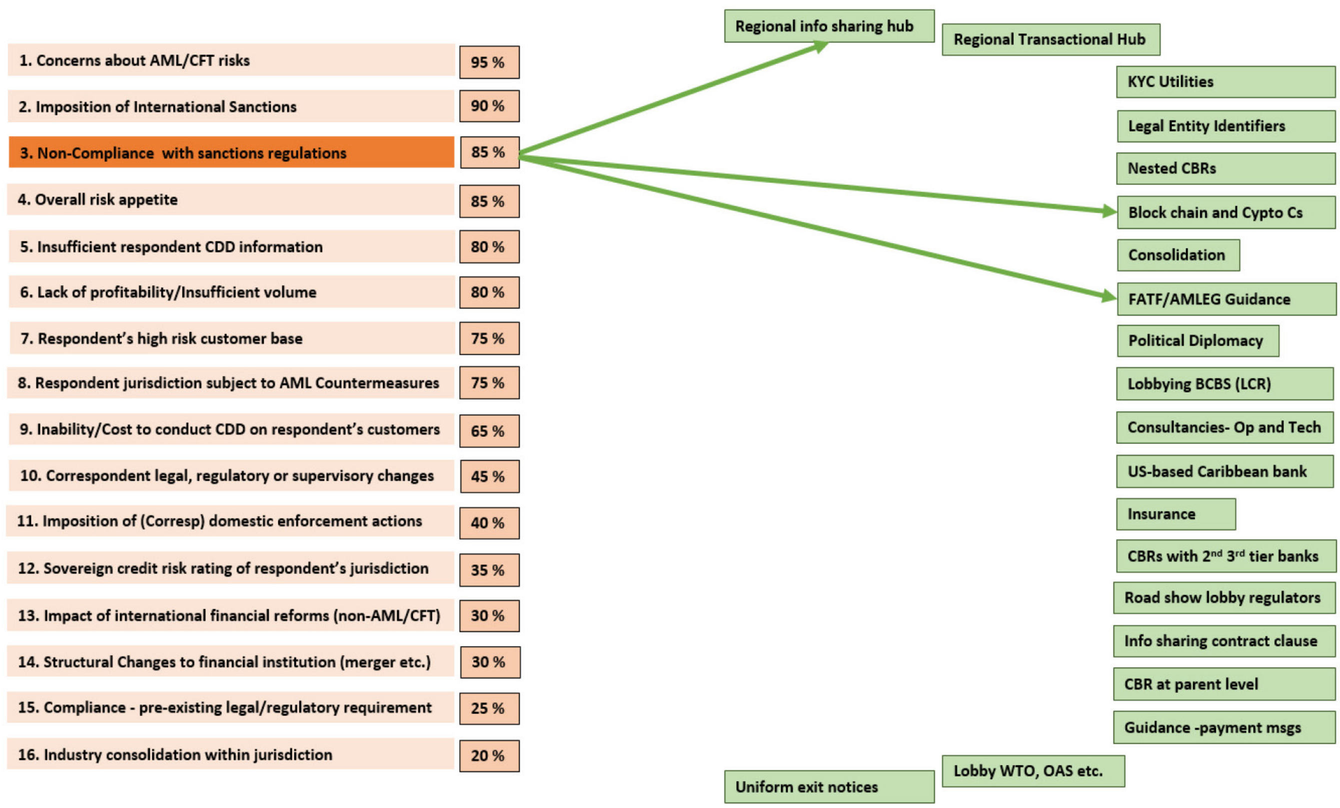
1. AML/CFT RISKS: Potential options for jurisdictions likely to be adversely impacted by a correspondent bank's concerns about AML/CFT risks.



2. IMPOSITION OF FINANCIAL SANCTIONS: Potential options for jurisdictions likely to be adversely impacted by a correspondent bank's concerns about imposition of financial sanctions.

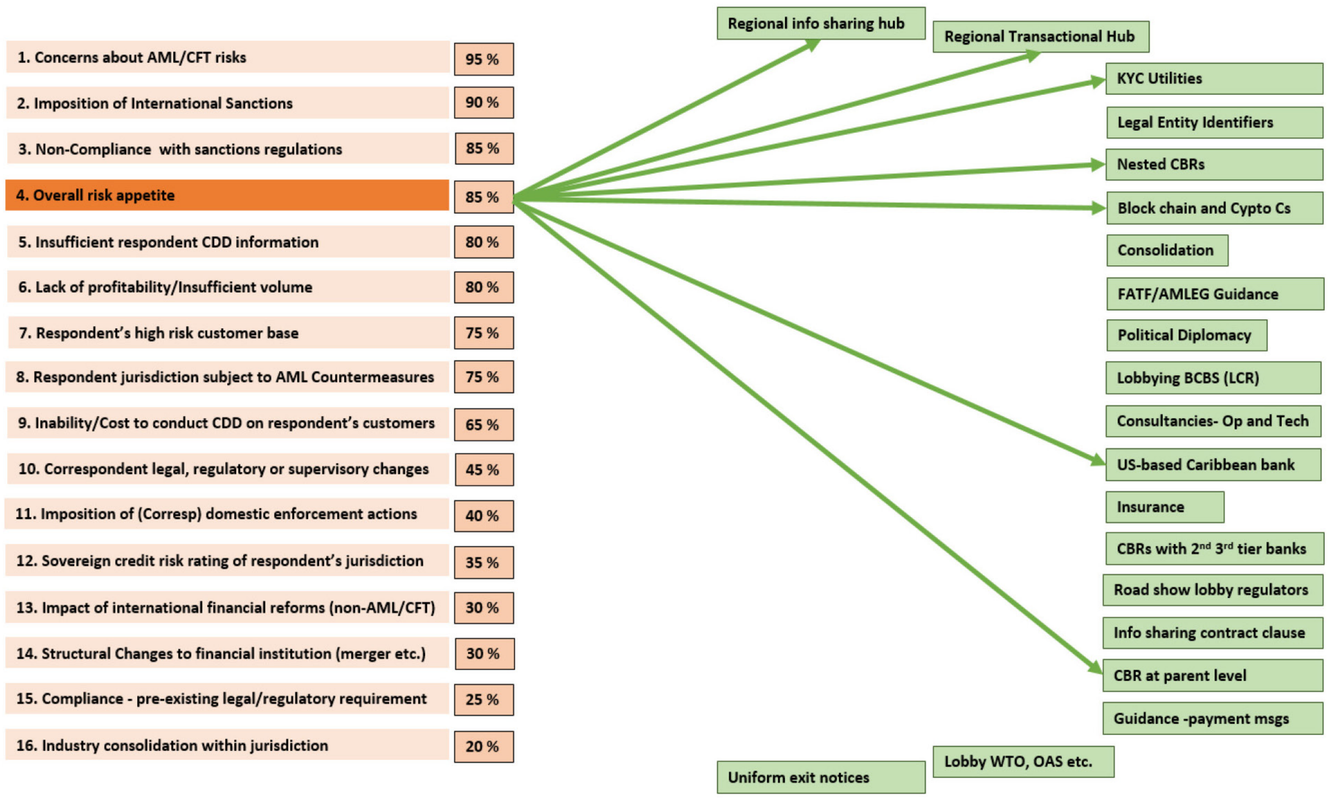


3. NON-COMPLIANCE WITH SANCTIONS REGULATIONS: Potential options for jurisdictions likely to be adversely impacted by a correspondent bank's concerns about non-compliance with sanctions regulations.

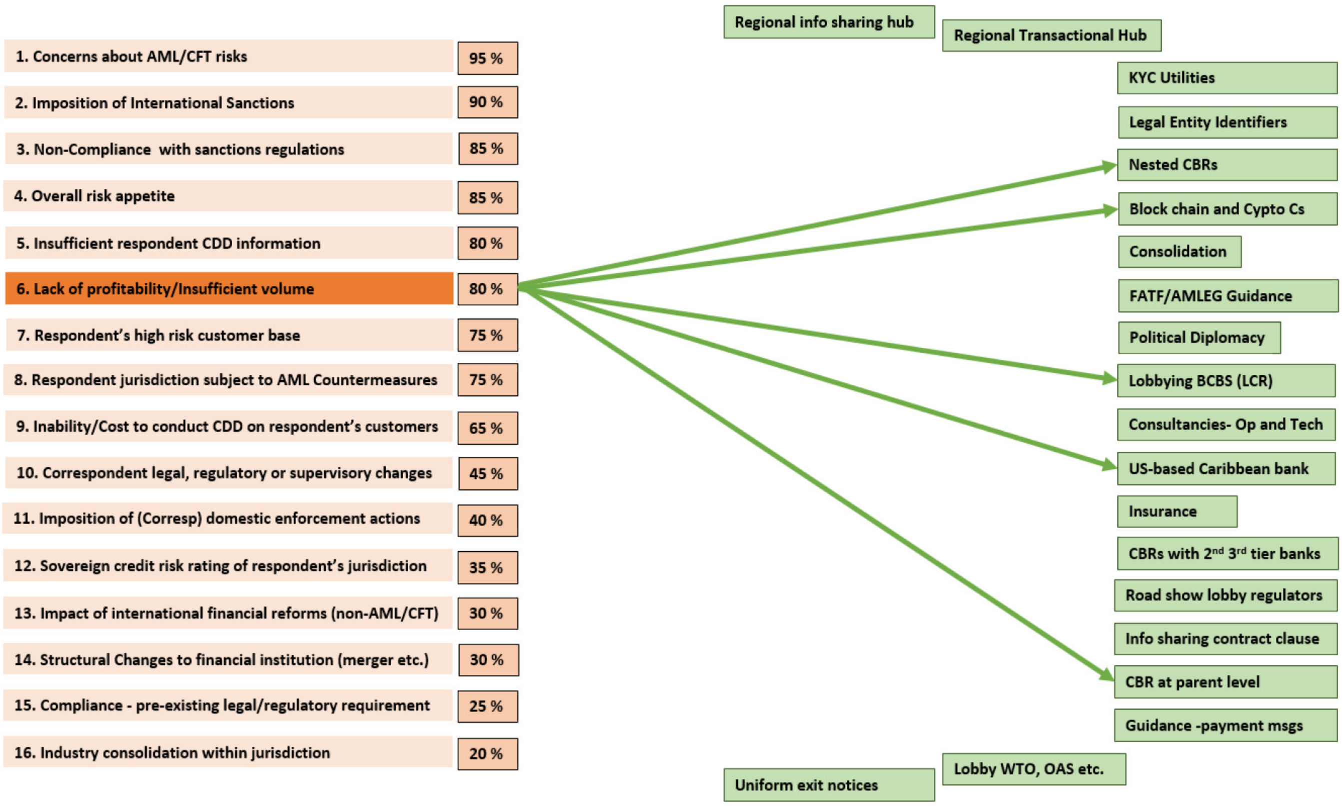


4. OVERALL RISK APPETITE: Potential options for jurisdictions likely to be adversely impacted by a correspondent bank's concerns about its overall risk appetite i.e. risk v reward.

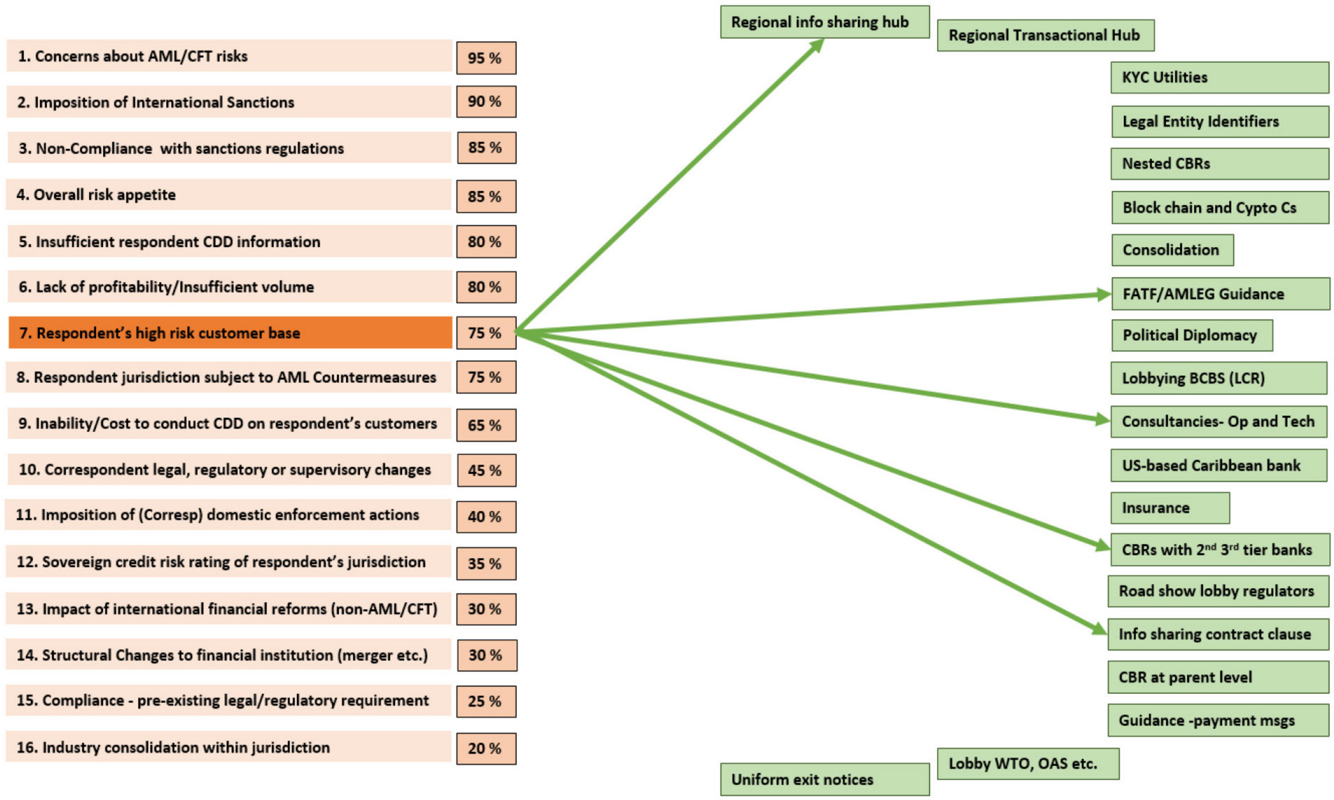
5. CDD INFORMATION: Potential options for jurisdictions likely to be adversely impacted by a correspondent bank's concerns about insufficient respondent CDD information.



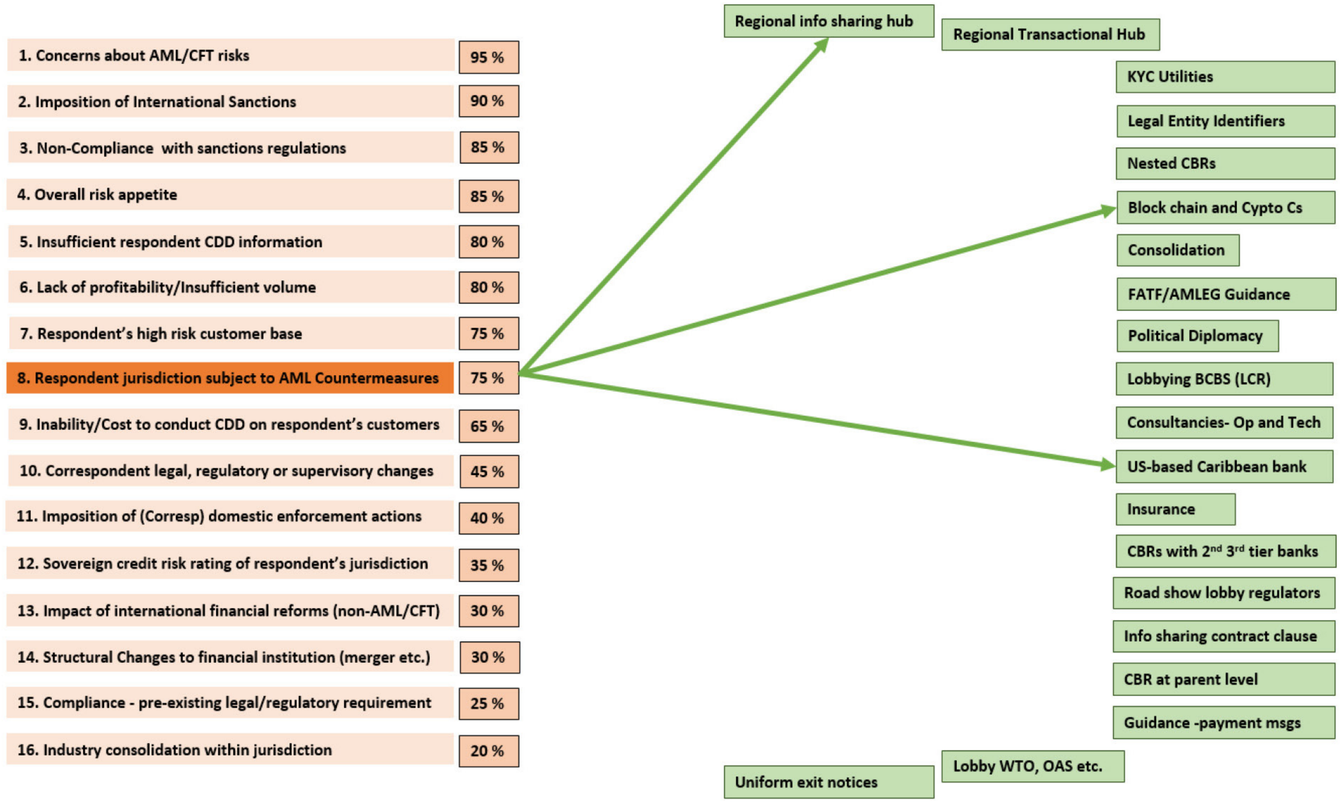
6. PROFITABILITY: Potential options for jurisdictions likely to be adversely impacted by a correspondent bank's concerns about lack of profitability and/or insufficient volume.



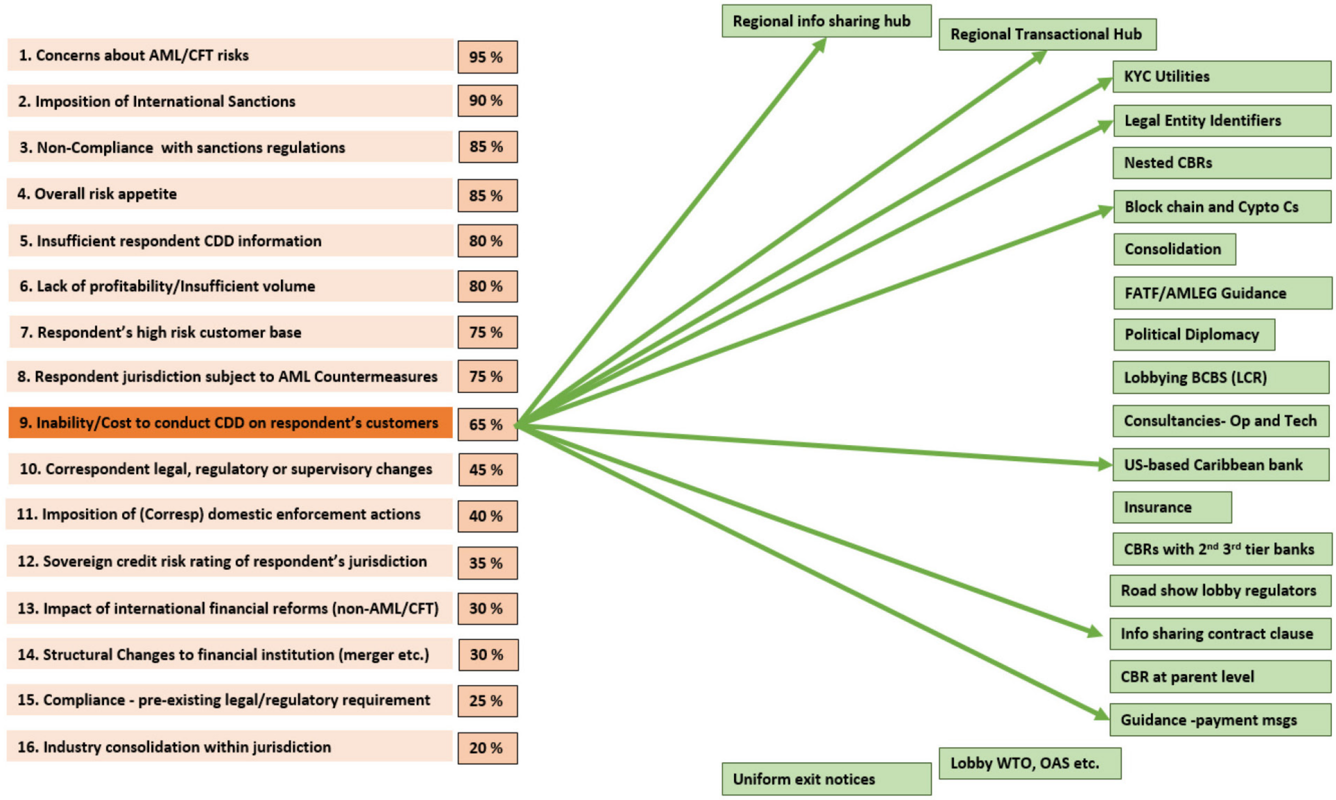
7. HIGH RISK CUSTOMER BASE: Potential options for jurisdictions likely to be adversely impacted by a correspondent bank's concerns about the respondent bank's high risk customer base.



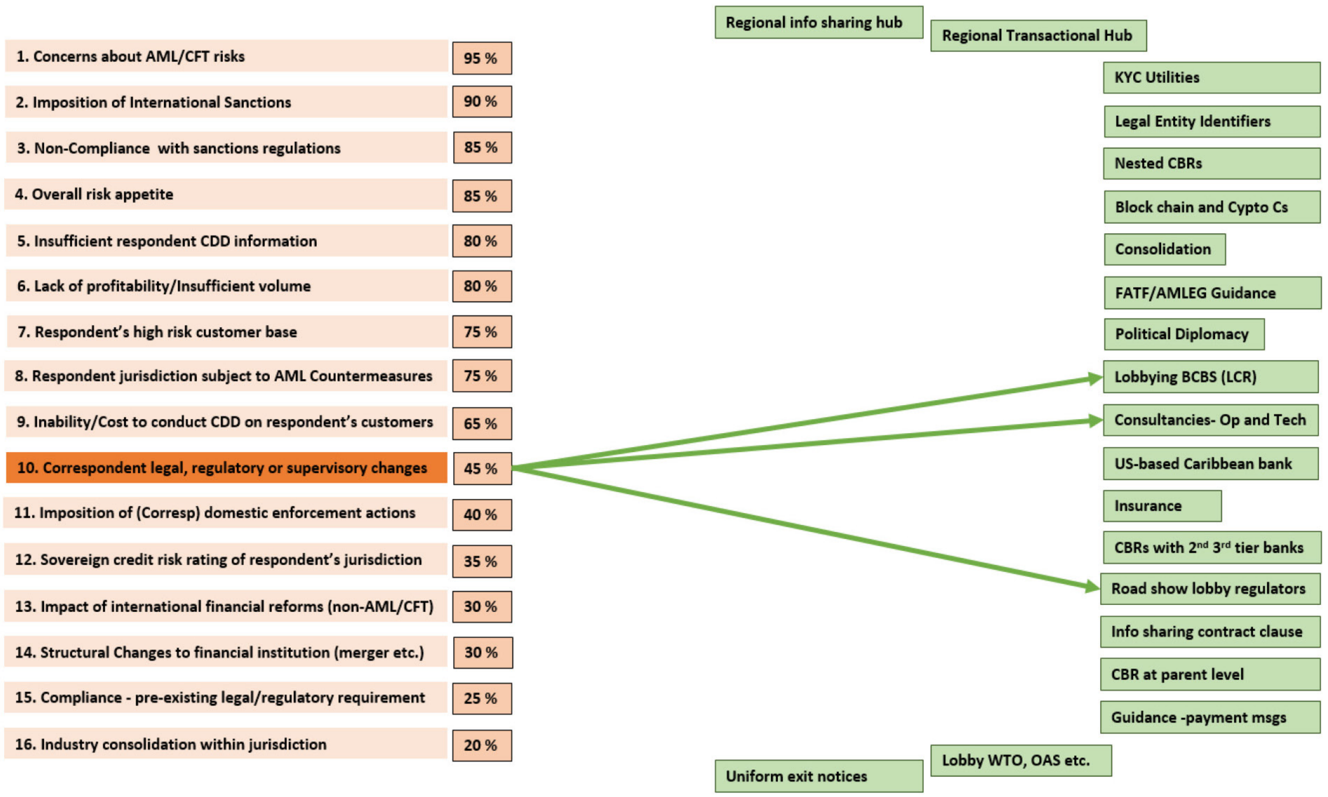
8. AML COUNTERMEASURES: Potential options for jurisdictions likely to be adversely impacted by a correspondent bank's concerns about the respondent's jurisdiction being subject to AML countermeasures.



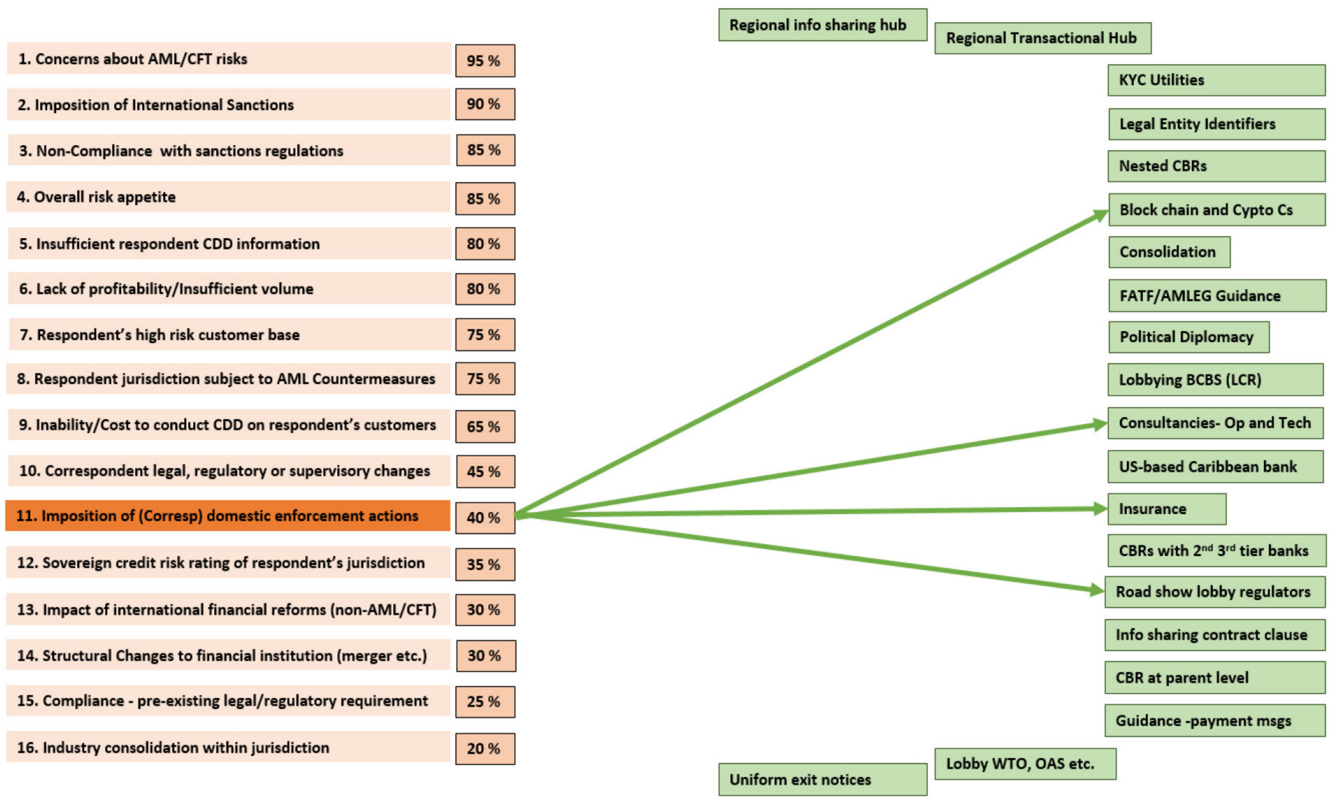
9. CDD ON THE RESPONDENT'S CUSTOMERS: Potential options for jurisdictions likely to be adversely impacted by a correspondent bank's concerns about its inability to conduct or the cost of conducting CDD on the respondent's customers.



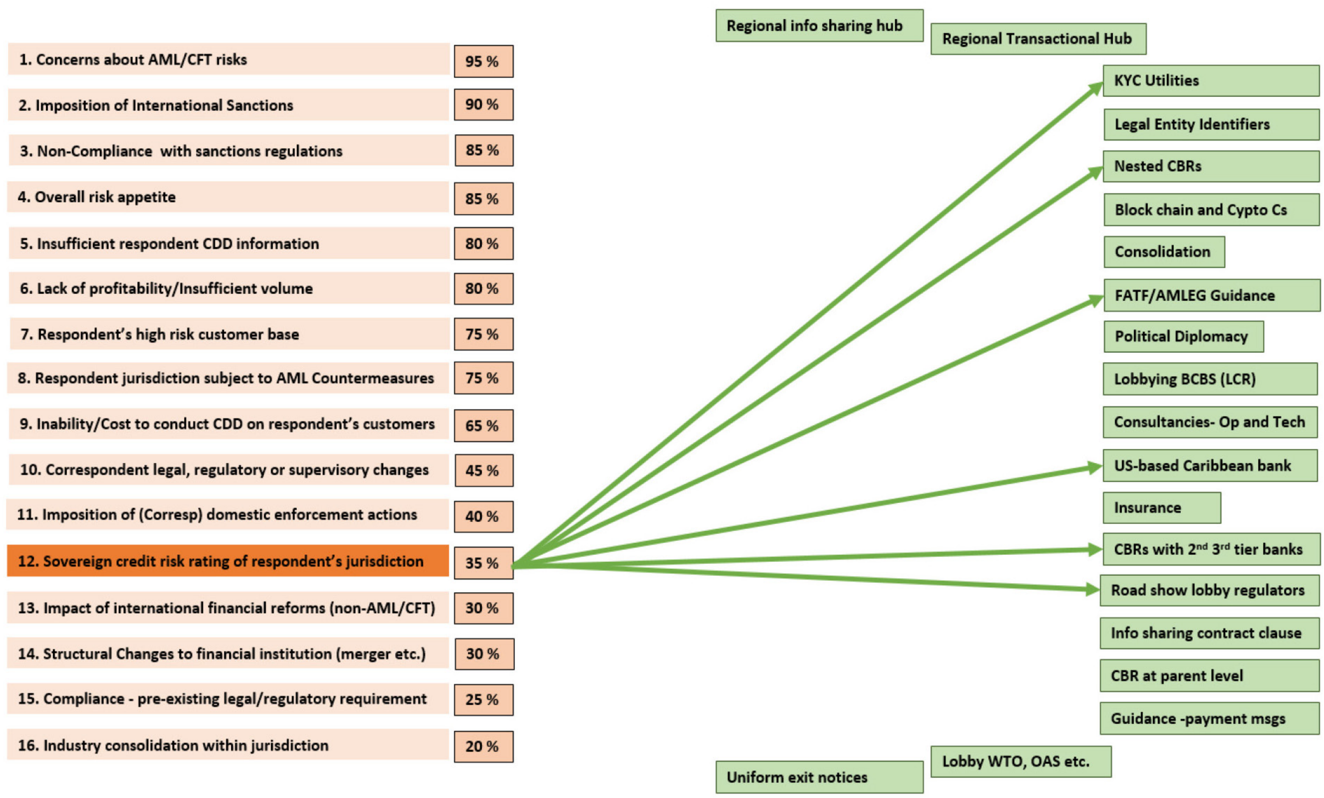
10. SUPERVISORY CHANGES: Potential options for jurisdictions likely to be adversely impacted by a correspondent bank's concerns about its own legal, regulatory or supervisory changes.



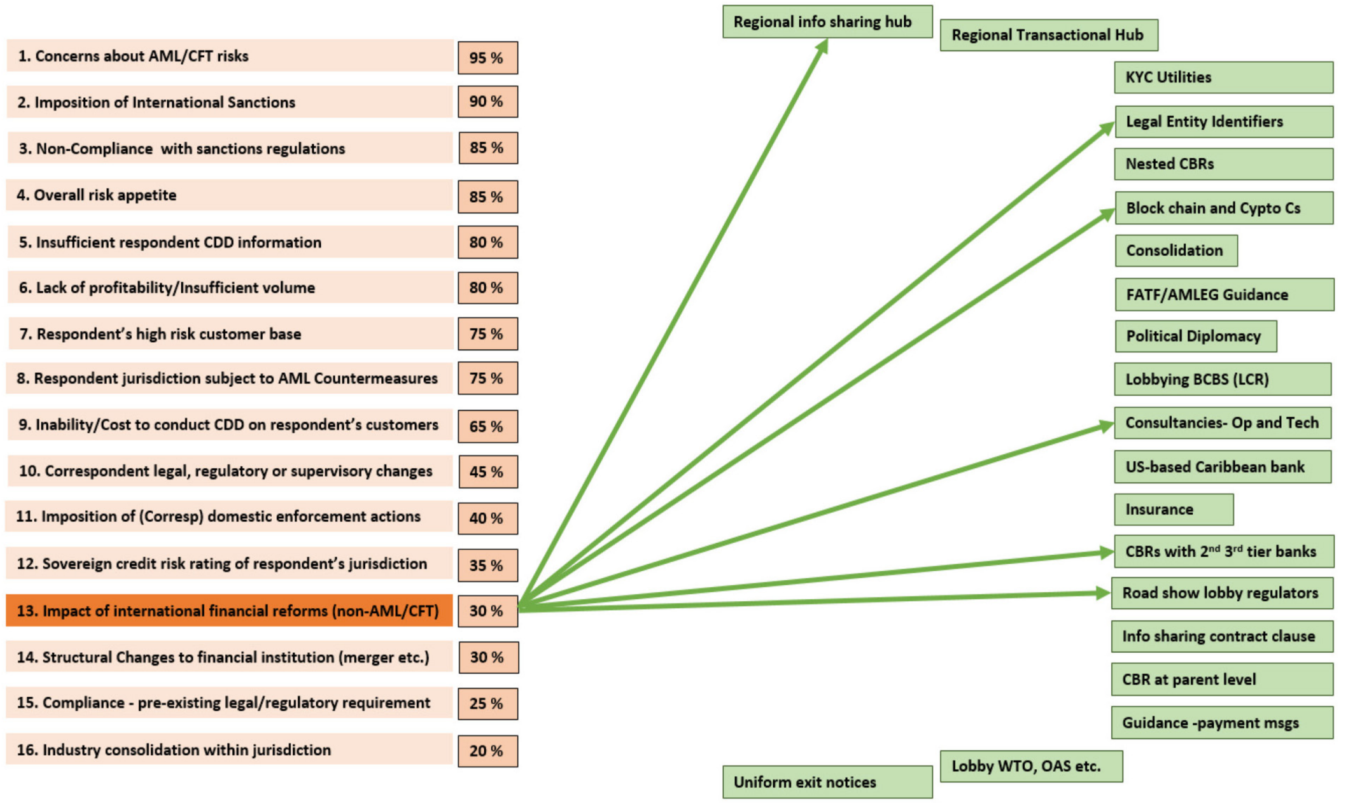
11. ENFORCEMENT ACTIONS: Potential options for jurisdictions likely to be adversely impacted by a correspondent bank's concerns about the imposition of domestic enforcement actions.



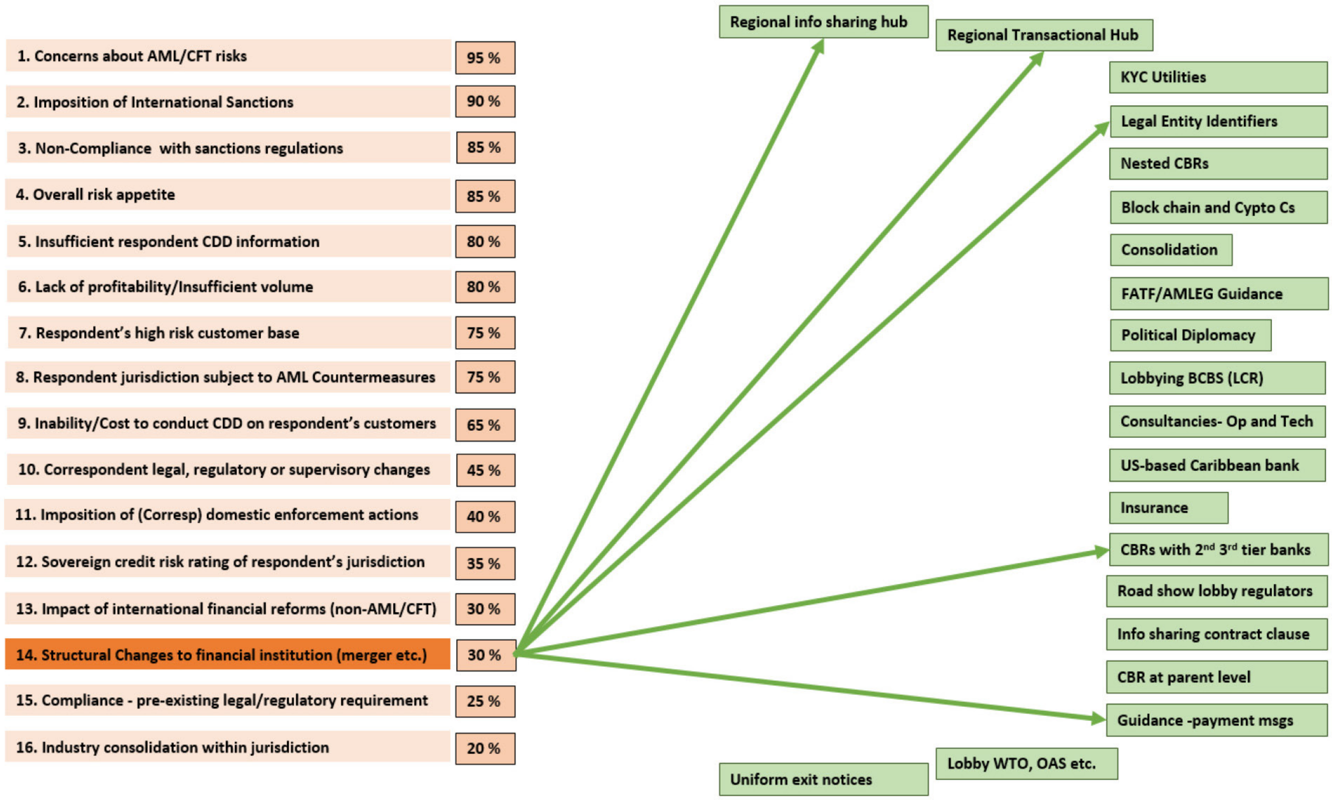
12. SOVEREIGN RISK RATING: Potential options for jurisdictions likely to be adversely impacted by a correspondent bank's concerns about the sovereign risk rating of the respondent's jurisdiction.



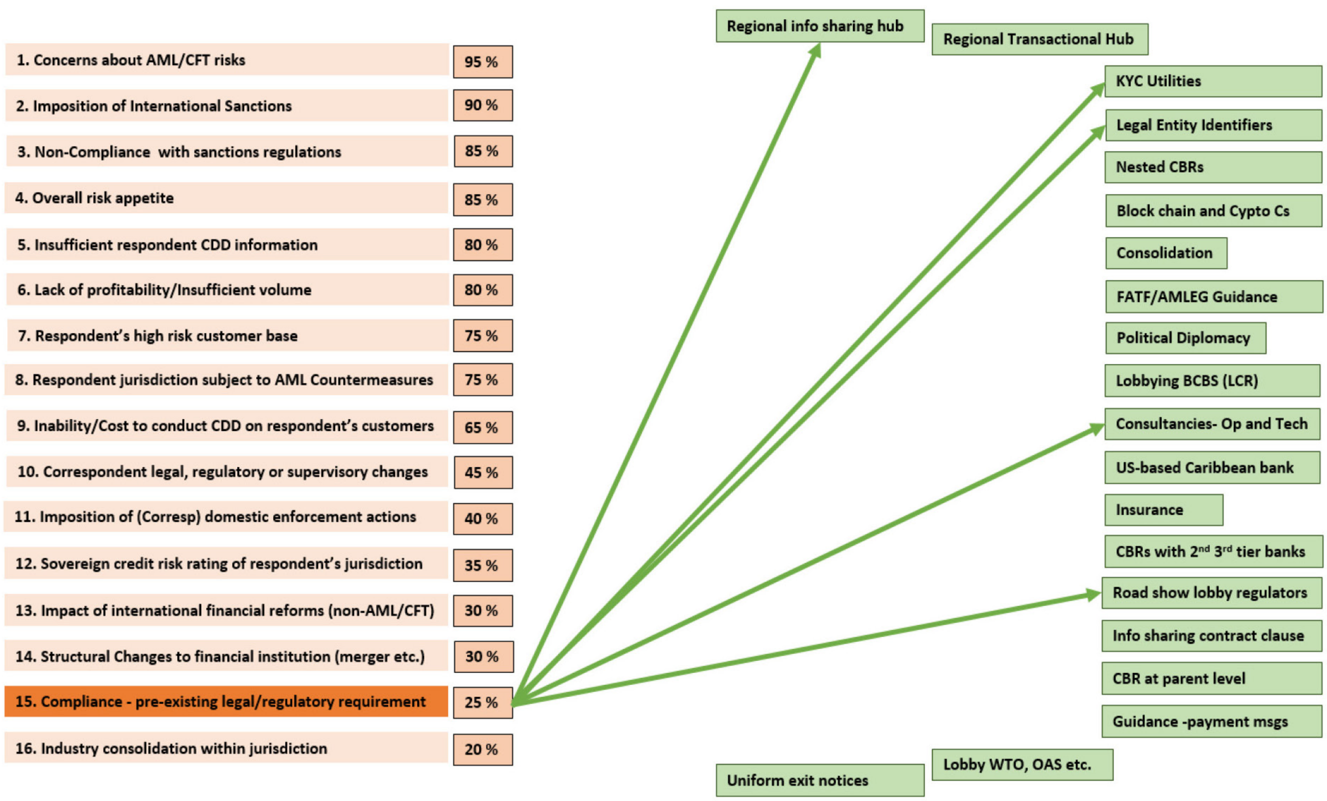
13. INTERNATIONAL FINANCIAL REFORMS: Potential options for jurisdictions likely to be adversely impacted by a correspondent bank's concerns about impact of international financial reforms (non AML/CFT-related).



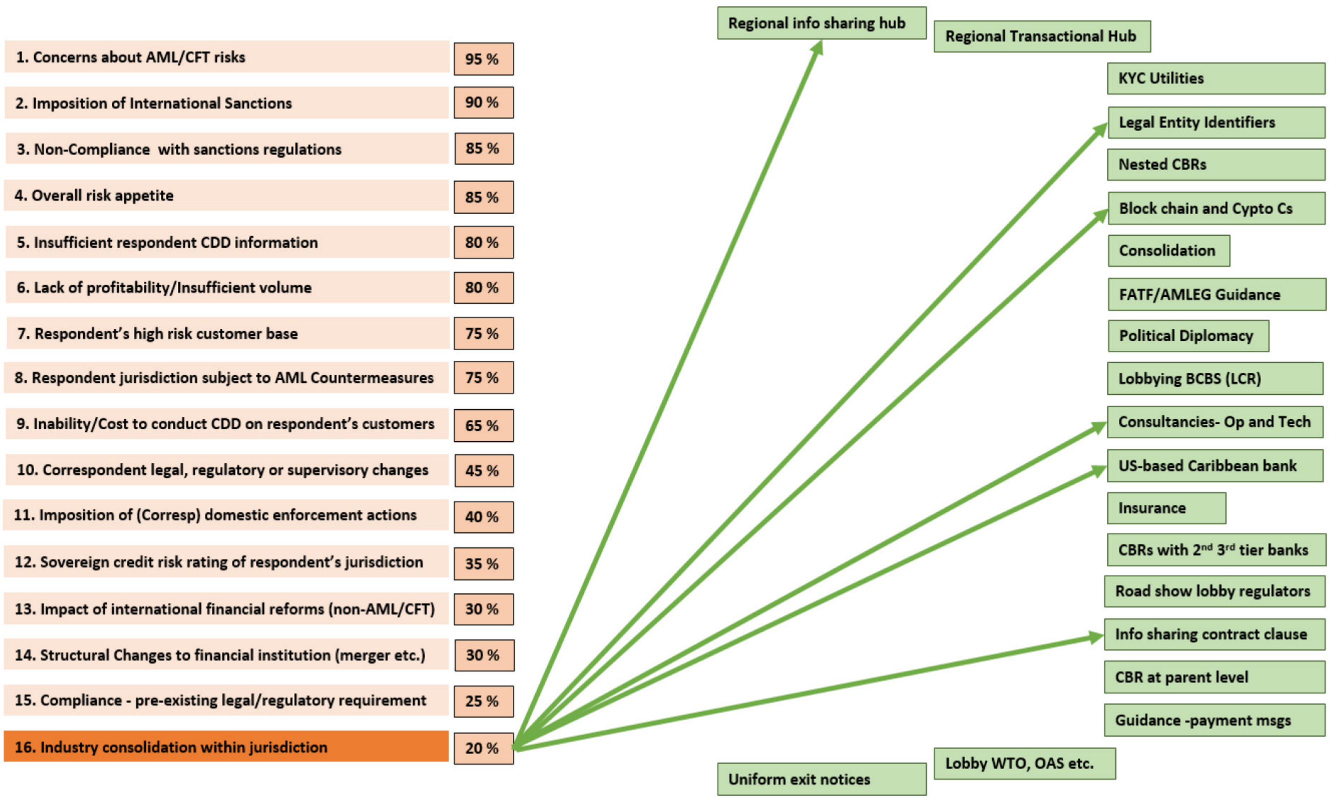
14. STRUCTURAL CHANGES: Potential options for jurisdictions likely to be adversely impacted by a correspondent bank's concerns about structural changes to the respondent/correspondent as a financial institution.



15. PRE-EXISTING LEGAL AND REGULATORY REQUIREMENTS: Potential options for jurisdictions likely to be adversely impacted by a correspondent bank's concerns about compliance and other pre-existing legal and regulatory requirements.



16. CONSOLIDATION: Potential options for jurisdictions likely to be adversely impacted by a correspondent bank's concerns about industry consolidation within the jurisdiction.



CONCLUSION

This Discussion Paper was simplified deliberately to help any stakeholder to understand the rationale, utility and flexible mechanics of the proposed “horses for courses” approach as one way (certainly not the only way) to move forward in the search for solutions. Ultimately, each stakeholder whether at the regional, national or institutional level should be able to use it as a tool or framework to determine what is most appropriate for them in assessing how to respond to pre-risking, re-risking and de-risking.

This Discussion Paper shows one way; one approach to rationalise the way forward but does not make any final specific recommendations about which solutions and mitigants are preferred by CDB for any particular stakeholder. However, some solutions do stand out and CDB through technical assistance stands ready to support our BMCs in studying, assessing and implementing, particularly those solutions that address the risk-reward ratio of high (potential) costs and low profitability, risk of enforcement action, complexity and information asymmetries. Some of these solutions include the information repository at the national level, consolidation of transactional traffic at the national level, insurance at the regional level, CBRs at parent level, LEIs, KYC Utilities and other measures that target the reduction of compliance and other operational cost to the foreign correspondent banks of doing business with respondent banks. Some of these solutions may also reduce the risk of sanctions and penalties and guarantee a minimum return to the correspondent banks of doing business with respondent banks from the Caribbean.

CDB takes seriously its supporting role in the resolution of this issue. Our expressed willingness to provide technical assistance, advocacy and share ideas through this Discussion Paper and our Policy Brief are all testament to our commitment to join with other stakeholders in moving this issue from being a list of problems, causes and drivers towards a lasting resolution.

ENDNOTES

[1] Financial Stability Board (FSB) to the G20, Report on the Actions Taken to Assess the Decline in Correspondent Banking, November, 2015.

[2] Caribbean Community's reporting in 'CARICOM must wage relentless campaign against threat to banking sector' CARICOM Today (February 16, 2016) at http://today.caricom.org/2016/02/16/caricom-must-wage-relentless-campaign-against-threat-to-banking-sector-pm-dean-barrow/

[3] See most recently US Department of the Treasury: Remarks by Acting Under Secretary Adam Szubin at the ABA/ABA Money Laundering Enforcement Conference (November 16, 2015) about what is and what is not "de-risking" and also Remarks by Under Secretary Nathan Sheets at the Institute of International Bankers (March 7, 2016).

[4] T. Boyce, 'De-Risking, Pre-Risking and Re-Risking of CBRs (forthcoming in May 2016) (2016) 31 J.I.B.L.R 305 – 310.

[5] See reported outcome of visit(s) by Belize to US regulators and response by US regulators; meeting between US regulators and Caribbean stakeholders in Jamaica; issue being raised at the energy security summit.

[6] Federal Financial Institutions Examination Council (FFIEC) BSA/AML Examination Manual p.178.

[7] FinCEN, Treasury, Final Rule, Customer Due Diligence Requirements for Financial Institutions 31 CFR 1010-1026 p.128

[8] FFIEC BSA/AML Examination Manual p.179.

[9] Hosted by the Central Bank of Barbados which, provides a regional perspective to complement the World Bank and FSB's work on causes and drivers and impacts in Caribbean jurisdictions.

[10] World Bank, Withdrawal from Correspondent Banking: Where, Why, and What to do about it (World Bank, November 2015).

[11] World Bank, Withdrawal from Correspondent Banking, p. 29.

[12] World Bank, Withdrawal from Correspondent Banking, p. 32.

[13] Communique issued at the conclusion of 27th CARICOM Intersessional Meeting, (February 19, 2016). Available at http://today.caricom.org/2016/02/19/communique-issued-at-conclusion-of-27th-caricom-intersessional-meeting/. This may also include lobbying the Organisation of American States (OAS).

[14] CPMI Consultative Report on Correspondent Banking (October 2015) p.21.

[15] Recommendation 1 of the FATF Recommendations (February 2012).

[16] World Bank, Withdrawal from Correspondent Banking, pp. 31 - 32.

[17] FATF President Roger Wilkins, 'The danger of driving both illicit markets and financial exclusion', Remarks at the 6th Annual International Conference on Financial Crime and Terrorism Financing, (Kuala Lumpur, 8 October 2014).

[18] FATF clarifies risk-based approach: case-by-case, not wholesale de-risking, (Paris, 23 October 2014).

[19] Drivers for "de-risking" go beyond anti-money laundering/terrorist financing (Brisbane, 26 June 2015).

[20] FATF takes action to tackle de-risking (Paris, 23 October 2015). Since 2013 the FATF has issued: (1) Guidance for a Risk-based Approach to Prepaid Card, Mobile Payments and Internet-based Payment Services (26 June 2013); (2) Guidance for a Risk-Based Approach to Virtual Currencies (26 June 2015); (3) Guidance for a risk-based approach:

effective supervision and enforcement by AML/CFT supervisors of the financial sector and law enforcement (23 October 2015) and most recently (4) Guidance for a Risk-Based Approach for Money or Value Transfer Services (23 February 2016).

[21] Also known as the 'BCBS AML/CFT Expert Group'.

[22] Available at https://www.treasury.gov/press-center/press-releases/Pages/jl0072.aspx

[23] Consultancy firms like Promontory Financial

[24] See the CPMI Report on correspondent banking 2015 p.12 which lists some KYC Utilities including: Thomson Reuters Accelus; SWIFT KYC Registry; Bankers Almanac; depository Trust Clearing Cooperation (DTCC) – Clarient Entity Hub; and Markit/Genpact KYC Service.

[25] World Bank, Withdrawal from Correspondent Banking, p.20.

[26] BIS, Basel Committee on Banking Supervision, Basel III: The Liquidity Coverage Ratio and liquidity monitoring tools, (January 2013) para 106.

[27] In the US for instance, operational deposits must meet eight qualifying criteria from which some correspondent banking deposits (though not all correspondent banking arrangements) are excluded from qualification. The wholesale unsecured deposits typically made pursuant to correspondent banking activities (i.e. arrangements whereby correspondent banks holding deposits owned by respondent banks and provide, overnight deposit accounts for excess funds, payment and other services in order to settle foreign currency transactions) are not treated as operational and will receive a 100% outflow treatment except to the extent that operational services are utilized by respondent banks, in which case associated deposits may be included as operational deposits. US federal regulators have noted in their Final Rule that the relative instability of correspondent bank deposits including excess funds placed in an overnight deposit, which do not warrant their classification as non-operational deposits a lower outflow rate. The liquidity risk profile of financial sector entities are significantly different from those of traditional corporate entities. They also noted that during the 2007-09 financial crisis, funding from wholesale counterparties including financial sector entities like respondent banks were generally more sophisticated than funding from retail counterparties and thus presents far greater liquidity risks to correspondent banks during a stress period when they tend to withdraw large amounts of funds to meet their obligations.

[28] One way to achieve this would be to adopt an activity-based approach to the classification of correspondent bank deposits.

[29] There does not appear to be any similar suggestion being made for the establishment of an equivalent presence in other countries like the United Kingdom and Canada.

[30] Once such entity is Crown Agents Bank owned by Helios Investment Partners (HIP) and which already serves many Caribbean-based financial institutions. Investors in HIP's funds include World Bank through its private sector arm the International Financial Corporation, Overseas Private Investment Corporation, the US government's development finance institution and the CDC Group. HIP is authorised by the UK's Prudential Regulation Authority and regulated the Financial Conduct Authority. Crown Agents conducts its KYC to the highest international standards.

[31] Available at: http://www.bis.org/cpmi/publ/d136.htm

[32] FFIEC BSA/AML Examination Manual p.179.

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