Frequently Asked Questions on De-Risking
November 18, 2016

Q1: What is "De-Risking"?

A: De-risking is the intentional rejection or termination of financial relationships with clients or groups of clients considered "high risk" to avoid, rather than manage, risks. Chiefly, the risk of money-laundering and terrorist financing. One form of "de-risking" is the withdrawal (or ending) of correspondent banking relationships (CBRs).

Q2: What are correspondent banks?

A: Correspondent banks are usually large, international banks located in places such as the United States of America, Europe and Canada. They provide vital access to the international financial system by offering services to banks and financial institutions, including those that operate from or with foreign jurisdictions such as The Bahamas and the Caribbean.

CBRs are essential for people and businesses to complete international payments. International payments and settlements are critical to developing regions of the world, because they support the trade in goods and services between countries, and the movement of capital and financing for businesses. For example, such arrangements allow consumers and businesses to:

- Receive payments for services provided to businesses and persons located abroad or payments for goods exported to other countries
- Make payment for purchases of goods and raw materials from abroad
- Make purchases online using credit cards or debit cards
- Wire funds abroad for various purposes such as medical expenses and college tuition
- Transfer wages earned to families abroad

Q3: Why are correspondent banks important in The Bahamas and the Caribbean?

A: The examples of transactions above are essential to the ongoing growth and development growth of our domestic economies and integration with the rest of the global economy. The flow of payments through and across countries also sustains the business model of international banks that operate inside The Bahamas. A loss of CBRs could threaten the region's banking sector, as local banks would no longer be able to complete international transactions on behalf of their customers.

Q4: How has The Bahamas been impacted?

A: As a result of de-risking, withdrawal of CBRs has gained some momentum in the last two years. According to the Bank's 2016 correspondent banking survey, approximately 26% of surveyed licensees indicated that they have been impacted by de-risking and/or the loss of a correspondent banking relationship. The impact has been primarily on standalone international banks and Bahamian-owned commercial banks.

All banks in the Bahamas still enjoy access to correspondent banks. However, some institutions have either had to establish new relationships or rely on fewer remaining ones. Both finding replacement CBRs and preserving existing relationships have become more demanding with banks experiencing greater scrutiny of their operations. *See the 2016 Correspondent Banking Survey findings for more details.*

Q5: What are the drivers of de-risking?

A: The drivers of de-risking are complex, and vary by country. The 2007-08 global financial crisis brought significant change to the financial sector. International banks now face higher fines, penalties and litigation costs for failing to comply with a variety of new laws and regulations. Due to more aggressive and high profile enforcement, there is also fear of reputational loss from being identified as conduits for money laundering or financing of terrorism. In addition, the ability to generate income from the deposits held in correspondent accounts have diminished considerably. These all impact profitability and the attractiveness of maintaining certain business relationships.

Among other things, this has raised concerns about:

- serving higher-risk categories of customers;
- the rising compliance costs;
- complex Anti-Money Laundering (AML) and counter-terrorist financing (CFT) requirements with greater risk of fines and reputational damage

Global banks are also reluctant to operate in countries and regions that are perceived to be higher risk, for example, due to the existence of "offshore" banking centres or perceived gaps in international tax transparency.

In response to these concerns, banks have adopted a range of approaches. These tactics are largely known as de-risking strategies. In addition to the termination of CBRs, some of these are: strategic market re-positioning, exiting certain markets, closing the accounts of selected clients and classes of clients, or relocation of business.

Q6: What are Caribbean governments and regulators doing about de-risking?

A: There has been a great deal of engagement on this topic, both at the international and regional levels. While being receptive to continued improvement in their anti-money laundering and combating financing of terrorism frameworks, Caribbean governments and regulators have consistently called for clarity from outside regulators and authorities to identify the specific gaps in Caribbean regulatory systems that pose "high-risk" concerns. Along with banking sector, stakeholders in affected jurisdictions have successfully lobbied for more attention to be given to providing clearer guidance on how correspondent banks should manage rather than sever high risk clients and relationships.

The Caribbean Community (CARICOM) has also committed to the Financial Stability Board's (FSB) four-point plan to address de-risking. A key part of that plan is building capacity in the countries where banks have been affected. In this instance, "capacity building" refers to any number of activities, from making the necessary changes to laws, regulations, and policies; to ensuring that those working within financial institutions have the necessary guidance, skills and training.

The discussion to understand and find solutions to de-risking has taken place in both regional and international forums which brought together, in the same rooms, Caribbean central banks and bank supervisors, US regulators and US law enforcement agencies, other foreign regulators, correspondent banks, Caribbean commercial banks, the FATF and FSB. Important studies to coalesce the issues have been undertaken by the IMF, World Bank and Commonwealth Secretariat.

Q7: How are we addressing this challenge in The Bahamas?

A: Like other regulators in the region, the Central Bank has participated in working groups and dialogue at the domestic, regional and international levels.

The Central Bank has generally raised awareness about the need for its licensees to remain compliant with AML and CFT regulations, and in alignment with international bodies such as the Financial Action Task Force (FATF). Other regulators and government entities have done the same.

In December 2015, the Bank released enhanced guidance on Anti-Money Laundering and Countering the Financing of Terrorism. This re-emphasized the high level of due diligence that banks and trust companies are required to observe when establishing and maintaining relationships with both local and international clients. Financial institutions are required to know at all times the ultimate persons either benefiting from or in control of funds passing through accounts or resting in accounts. Alternatively, they must have assurance that other banks or trust companies from which the funds originate can provide such answers. Institutions must also maintain adequate systems that can flag transactions that are suspected of being criminal in nature and report them to law enforcement agencies for investigation.

The Central Bank continues to monitor the market by gathering information through surveys and interviews. The Bank also intends to provide ongoing support to the regulated community regarding this important topic.

The Bank is also committed to working with other regulators, and the public, to develop policies for the government that help manage risks in the sector. Examples of this include promoting reforms that provide greater access to domestic banking services by all persons, thereby reducing the prevalence of untraceable activities outside the banking system. The Bank is also accelerating efforts to modernize the payments system and provide consumers and business with greater access to non-cash means of transacting. These are offshoots of a policy to promote financial inclusion.

The greater ease of information flow and information sharing between financial institutions is also important. The Central Bank will explore how this can be achieved through changes in laws and regulations, including approaches that would allow financial institutions to share the cost of investments in automated systems for transactions monitoring.

Other measures are discussed in the Bank's press release dated 18 November, 2016: ***The Central Bank: Managing the "Threat" of De-risking in The Bahamas.***

ADDITIONAL REFERENCE MATERIALS

CARICOM Central Bank Governors Technical Working Group on De-Risking, 2016. "De-Risking and its Impact: The Caribbean Perspective" available at:

http://www.ccmf-uwi.org/?q=node/1930

Commonwealth Secretariat, 2016. "Disconnecting from Global Finance: The Impact of AML/CFT Regulations in Commonwealth Developing Countries" available at:

http://thecommonwealth.org/sites/default/files/inline/DisconnectingfromGlobalFinance2016.pdf

FATF, 2016. "Guidance on Correspondent Banking Services" available at:

http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-Correspondent-Banking-Services.pdf

IMF, 2016. "The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action" available at:

https://www.imf.org/external/pubs/ft/sdn/2016/sdn1606.pdf

World Bank, 2015. "Withdrawal from Correspondent Banking; Where, Why, and What to Do About It" available at:

http://documents.worldbank.org/curated/en/113021467990964789/pdf/101098-revised-PUBLIC-CBR-Report-November-2015.pdf