



The Commonwealth

Discussion Note

Commonwealth Central Bank Governors Meeting 2016

De-risking: The Impact in Commonwealth Developing Countries and the Need for a Solutions Focus

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Abstract

This note provides a summary of the Commonwealth's work on 'de-risking', which is presented in greater depth in the Commonwealth report, *Disconnecting from Global Finance: De-risking – The Impact of AML/CFT Regulations in Commonwealth Developing*

Countries. The report aims to improve understanding of the issues surrounding de-risking and, more importantly, to identify a number of practical solutions to the de-banking of legitimate banks, businesses and individuals.

Guiding questions

- What are governors' views on the recommendations and solutions identified in this note?
- What is needed to take these solutions forward? What role can the Commonwealth and the Commonwealth Secretariat play in this?

1. Commonwealth engagement on de-risking

In October 2014, Commonwealth central bank governors expressed growing concern about the adverse impacts of anti-money laundering and countering the financing of terrorism (AML/CFT) regulations on their countries' economic and social development. The Secretariat took these concerns forward, tabling them for discussion with the G20, before convening a 2-day expert forum in July 2015 and surveying its members on de-risking later that year. The Secretariat has also engaged with a number of key international organisations, regulatory bodies and banks to promote the concerns of Commonwealth countries and identify solutions to these issues (see Figure 1 for more information).

Figure 1 Background to Commonwealth engagement on de-risking



2. Overview of de-risking in the Commonwealth

De-risking has increased significantly in recent years, affecting correspondent banking relationships, remittance flows and financial inclusion in many developing countries. The loss of correspondent banking relationships (CBRs) has been particularly significant for several of our members leaving many banks, businesses and individuals in the Commonwealth without access to essential financial services. In fact, 18 of the 23 Commonwealth developing countries for which data was received reported CBR losses in the last 4 years, with 70 per cent of these closures experienced since 2015, as shown in Figure 2.

A lack of available data precludes systemic judgements on the causes of de-risking, but there is increasing recognition that the implementation and interpretation of AML/CFT regulations is a major factor behind the de-banking of legitimate businesses and individuals in developing countries

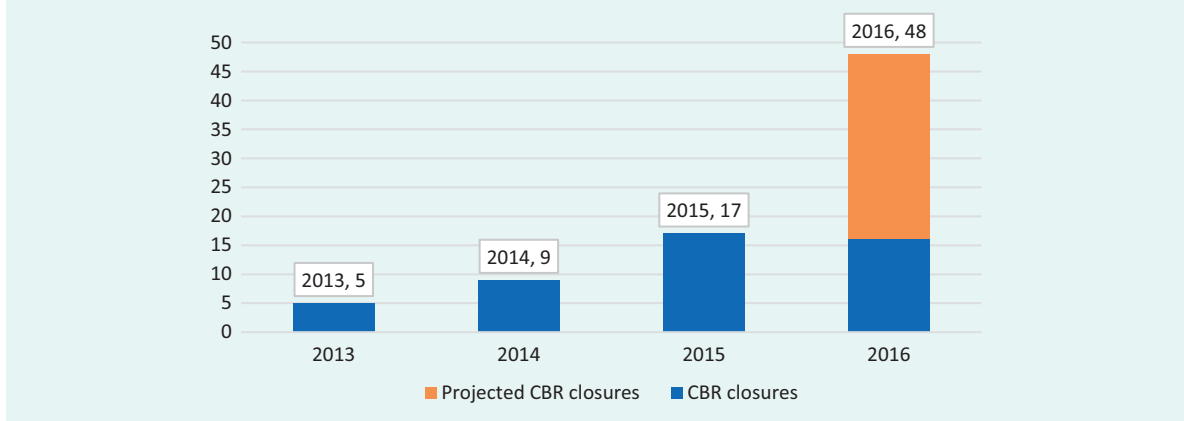
(Center for Global Development, 2015; World Bank, 2015).

These findings are supported by the results of the Secretariat’s survey on de-risking, conducted in 2015, where the majority of member countries identified decreased profitability – as a result of increased monitoring and compliance costs associated with AML/CFT regulations – as the predominant driver of de-risking, followed by concerns over reputational risks and shifts in risk appetite.²

3. Policy solutions

The Secretariat has been working with its member countries, international banks, money services businesses (MSBs) and other key stakeholders to develop solutions to address the drivers and consequences of de-risking. The Commonwealth’s survey on de-risking asked countries to rank solutions based on their perceived effectiveness in countering the

Figure 2 Correspondent bank account closures in Commonwealth developing countries



adverse consequences of AML/CFT regulations. The outcomes of the survey were augmented by discussions with member countries, banks, MSBs and international organisations, which generated a set of recommendations for combating de-risking. These proposals are summarised in Box 1.

Box 1 Commonwealth Secretariat recommendations

- **Global forums:** several Commonwealth countries reported low levels of engagement or consultation in setting Financial Action Task Force (FATF) standards and/or in determining AML/CFT regulations in major countries in their regions. Increasing the membership of the FATF and the Financial Stability Board (FSB) to include more developing countries and regional organisations would ensure that developing countries contribute more to, and have a greater understanding of, international standards.
- **Guidance for banks:** national guidance clearly demonstrating the responsibilities and liabilities of banks regarding AML/CFT regulations and outlining how banks should deal with 'higher-risk' customers could discourage de-risking.
- **Best practice standards for MSBs:** produced in conjunction with banks, regulators and MSBs, these standards could increase the legitimacy and reputation of the MSB sector.
- **Capacity-building:** countries alluded to the need for better targeted and more predictable capacity-building assistance. A platform for identifying individual countries' specific capacity constraints is required to ensure more effective capacity-building efforts by international bodies and donors.

In addition, many Commonwealth governments, domestic and regional banks, MSBs and regulators have undertaken initiatives aimed at tackling the inadvertent consequences of AML/CFT regulations. The Secretariat intends to examine these proposals (some of which are listed in Box 2) to determine their applicability to other Commonwealth countries/regions. The results of this analysis will be shared with member countries.

Box 2 Country and technical solutions

- **CBR pooling:** the pooling of correspondent banking services by local and regional Caribbean banks is being investigated by a number of Caribbean countries as a potential solution to CBR closures. The proposed pooling of these services could increase their profitability and appeal to potential correspondent banks.
- **Regional centralised information repositories:** another suggestion is centralised regional databases where local and regional banks can store information on the identities and transactions of their customers involved in cross-border payments. This could reduce compliance costs and enable correspondent banks to build comprehensive customer risk profiles. The establishment of a regional repository could be strengthened through the use of a common Know Your Customer facility by all banks operating in the region and the adoption of legal entity identifiers.
- **Non-bank providers:** several banks have found alternative relationships with non-bank providers of payment services. Regulators in some countries are starting to realise the benefits of increasing competition in payment services and are investigating allowing non-bank 'payment service providers' direct access to their payment systems, thereby avoiding the difficulties associated with third-party payments through CBRs.
- **Categorisation of MSB licences:** several Commonwealth countries are considering categorising their MSB licences to help inform and improve banks' understanding of their local remittance markets. The categorisation of licences by type of MSB can help inform banks about the nature of their clients' business, and reduce their due diligence and monitoring requirements. However, this categorisation must be incorporated into a broader assessment of customer, product and other risks, and should not be used to facilitate the identification and subsequent de-banking of categories of customer.

4. Conclusion

De-risking restricts financial access to legitimate individuals, businesses, banks and even governments, representing a significant threat to a number of member countries. The Secretariat will work to promote the voice and perspective of Commonwealth developing countries at the international level, and will continue to engage with all relevant parties to identify practical and effective solutions to de-risking at the national, regional and international level. The assistance of all members in this endeavour through the sharing of their solutions and experiences with tackling de-risking will help advance the Secretariat's work in this space.

References

Center for Global Development (2015), 'Unintended consequences of anti-money

laundering policies for poor countries', CGD Working Group Report, available at: <http://www.cgdev.org/sites/default/files/CGD-WG-Report-Unintended-Consequences-AML-Policies-2015.pdf> (accessed January 2016).

World Bank (2015), 'Withdrawal from correspondent banking: where, why, and what to do about it', Working Paper, Report Number 101098, Vol. 1., available at: <http://documents.worldbank.org/curated/en/2015/11/25481335/withdraw-correspondent-banking> (accessed December 2015).

Notes

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- 2 Commonwealth Secretariat (2015), Commonwealth Survey on De-risking, unpublished survey data.