WHEN BANKS LEAVE: THE IMPACTS OF DE-RISKING ON THE CARIBBEAN AND STRATEGIES FOR ENSURING FINANCIAL ACCESS

HYBRID HEARING

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CONTENTS

WHEN BANKS LEAVE: THE IMPACTS OF DE-RISKING ON THE CARIBBEAN AND STRATEGIES FOR ENSURING FINANCIAL ACCESS

Wednesday, September 14, 2022

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:17 a.m., in room 2128, Rayburn House Office Building, Hon. Maxine Waters [chairwoman of the committee] presiding.

Members present: Representatives Waters, Velazquez, Sherman, Meeks, Cleaver, Perlmutter, Himes, Beatty, Vargas, Gottheimer, Lawson, San Nicolas, Axne, Casten, Pressley, Lynch, Adams, Dean, Garcia of Illinois, Garcia of Texas, Williams of Georgia, Auchincloss; McHenry, Posey, Luetkemeyer, Huizenga, Wagner, Williams of Texas, Hill, Zeldin, Mooney, Davidson, Gonzalez of Ohio, Timmons, and Sessions.

Chairwoman WATERS. The Financial Services Committee will come to order.

Without objection, the Chair is authorized to declare a recess of the committee at any time.

Today's hearing is entitled, "When Banks Leave: The Impacts of De-Risking on the Caribbean and Strategies for Ensuring Financial Access."

I now recognize myself for 5 minutes to give an opening statement.

I would like to welcome the Prime Minister of Barbados, the Honorable Mia Amor Mottley, to the Financial Services Committee, and thank her for being here to discuss an issue that I have long dedicated my time to solving: the crisis of bank de-risking in the Caribbean. By appearing here today, Prime Minister Mottley is giving voice to a topic that matters to every person in the Caribbean and, as we will discuss, everyone in the United States too. Today's testimony by Prime Minister Mottley isn't just timely. It is historic. It marks the first time in nearly 40 years that a Prime Minister will testify before Congress. Her presence today underscores the gravity of this issue and the urgent need to take serious steps to end the deterioration of global financial access for her nation and the whole of the region. Prime Minister Mottley, I am so pleased to welcome you to the United States, and I look forward to hearing your testimony and listening to the ways we can all work together to reverse de-risking.

I am also pleased to acknowledge Dr. Keith Rowley, the Prime Minister of Trinidad and Tobago. Thank you, Mr. Prime Minister, for joining us to lend your support. For too long, the lack of financial access faced by Caribbean nations and their majority Black populations has been blatantly ignored. As chairwoman of the committee, and even long before I became the Chair, I have worked with stakeholders to combat the de-risking we have seen harm businesses and families across the Caribbean and the United States for more than 10 years.

Financial access is key to a nation's stability, but for our neighbor island nations whose economies rely on cross-border transactions, they are being denied this path to prosperity and resiliency. The Caribbean is very close to the United States, not only in geography, but also in its shared economy, culture, and security. This is reflected in the mutual trade and tourism, which fuels jobs and economic growth here and in the region, as well as in the 8.5 million members of the Caribbean diaspora community who have chosen the United States as their home. We must acknowledge that our nation's security and well-being is directly linked to that of the Caribbean nations, and that dwindling financial access endangers these mutual benefits.

That is why back in April, Prime Minister Mottley and I led the Caribbean Financial Access Roundtable with nearly a dozen heads of state, Members of Congress, and other stakeholders to discuss concrete solutions. In addition, my committee worked to secure key anti-money laundering provisions in the 2021 National Defense Authorization Act, including a mandate for a United States Government-wide strategy to address financial de-risking. Without action on this issue, we risk ceding our leadership in this region to countries like China and Russia, which have been working hard in recent years to become more active in the Caribbean. It is clear that combating the loss of United States correspondent banking relationships in the Caribbean should be a mutual priority for both the Caribbean and the United States.

Solving this crisis requires us to work together, from government examiners, to correspondent banks, to civil society organizations, to international financial institutions and standard-setting organizations. Congress has a role, too. Under my leadership, the committee continues to press for action on the collaborative solutions needed, solutions like removing any unsubstantiated stigma of the region, and government reports and helping to streamline bank examinations to name a few. Now is the time to move on these measures. Thank you.

And I now recognize the ranking member of the committee, the gentleman from North Carolina, Mr. McHenry, for 5 minutes.

Mr. MCHENRY. Thank you, Madam Chairwoman, and Prime Minister, thank you for being here. It is an honor to have you before our committee, and Madam Chairwoman, thank you for having this hearing.

De-risking is a critical issue, and the last time we talked about de-risking in a committee hearing was back in 2008. But that was domestic de-risking, and that was led by the subcommittee ranking member, then-Chair of the Financial Institutions Subcommittee, and it was analyzing the impact of Operation Choke Point in the then-Obama Administration and the impact that Operation Choke Point had on consumers, small businesses, and communities. But that was a domestic walk.

Today, we are looking at the global landscape and the implications of de-risking at a macro level, and that is important, but those issues are similar, whether they are domestic or international. The underlying factors of de-risking remain the same between both domestic and international functions, and overly-punitive supervisory examination tactics employed by Federal financial regulators can have serious implications.

Take, for example, the availability of banking services in jurisdictions deemed high risk, like the Caribbean, as well as towns along the southern U.S. border. It is one thing if de-risking is an evidence-based response to illicit finance, and let me be clear, we support that, and I think that we have bipartisan support to do that. But when innocent people and legitimate businesses are being shut off from financial services, we need to take a step back. We should re-examine our approach to ensure that we are not lumping the good in with the bad.

And the problem is this. The penalty for failing to comply with any money laundering regulation can be so devastating for financial institutions, especially small and medium-sized banks, that they turn to defensive approaches to ensure compliance. Republicans have raised this issue numerous times in the context of suspicious activity reports (SARs). Many banks carry out defensive SAR'ing to ensure that they don't get penalized. In 2021 alone, this resulted in over 3 million reports being generated, and I expect that we will see a new record set every year moving forward.

It is through this lens that we approach Caribbean de-risking. U.S. banks were faced with a difficult decision. Regulatory compliance costs and the penalties for noncompliance are so steep that financial institutions would rather end customer relationships than run afoul of regulators. The result is large-scale de-risking and debanking for entire geographic areas that can sweep up ordinary people and small businesses, and have severe economic consequences and severe consequences for friends, allies, and neighbors. And the question of the day is this: Where do those de-banked customers go? I will tell you—China—and these are our neighbors. These are our friends. These are our traditional allies. These should be some of the closest relationships the United States has in the world.

According to the report entitled, "Financial De-Risking in the Caribbean," which was authored by one of today's witnesses on the second panel, from 2009 to 2016, Chinese correspondent banking relationships grew from 65 to 2,246. To put it in another way, over an 8-year span, China gained 2,181 new ways to engage with partners in developing regions like the Caribbean. As a matter of American policy, why are we driving people away from our friendship as a nation and towards seeking a country that does not adhere to our rules of law, our concept of human rights, and our struggle to improve human rights?

Think about this. Our current regime that compels banks to over-file reports to not get penalized is actually driving customers to regions that regulators deemed high risk, underperforming, or worse, in the financial arms of the Chinese Communist Party (CCP). I would argue it is in the best interest of our financial system communities of law enforcement and the Federal Government to be able to monitor and maintain these global banking relationships and friendships.

I look forward to hearing from the Prime Minister today, as well as the witnesses on the second panel. Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you, Mr. McHenry. As a reminder, we will have two separate witness panels today. After the first panel concludes, we will take a very brief recess before proceeding with the second panel.

The sole witness on our first panel is the Honorable Mia Amor Mottley, the Prime Minister of Barbados. Prime Minister Mottley is an attorney, a member of parliament, her nation's minister of finance, economic affairs, and investment, as well as minister of national security and civil service. She is a leader in the Caribbean Community (CARICOM) Secretariat, and one of Time magazine's 100 Most Influential People for 2022.

Prime Minister Mottley, you will have 5 minutes to present your oral testimony. You should be able to see a timer that will indicate how much time you have left.

And without objection, your written statement will be made a part of the record.

You are now recognized for 5 minutes to present your oral testimony.

STATEMENT OF THE HONORABLE MIA AMOR MOTTLEY, K.C., M.P., PRIME MINISTER OF BARBADOS; MINISTER OF FINANCE, ECONOMIC AFFAIRS AND INVESTMENT; MINISTER OF NATIONAL SECURITY AND CIVIL SERVICE [WITH RESPONSIBILITY FOR CULTURE AND CARICOM MATTERS]

Ms. MOTTLEY. Thank you very much, Chairwoman Waters, and Ranking Member McHenry, and thank you for having me here. I want to acknowledge my colleague and brother, the Prime Minister of Trinidad, the Honorable Keith Rowley, who is also here this morning, and appropriately so, because even though they don't have an offshore banking sector, they are the owners of 2 of the 5 banks in Barbados, and, therefore, have a vested interest in this issue. I want to say especially to the ranking member that you can be assured that while Barbados sent the first seven governors to the Carolinas, I am not here for that purpose at all today, and therefore, you need not worry. But I am here to tell you who we are and what faces us when banks leave.

Our reality is that we in the Caribbean community are a community of sovereign nations of 15 countries, and we have a collective GDP of $82 billion. There are 41 States in the United States of America that have a larger GDP than all 15 member states of CARICOM. It is important that we appreciate that context first. The irony is that the State that is closest to us in terms of GDP, at $80 billion, is the State of Delaware. But that speaks to other opportunities, I suspect, as to why Delaware and Wyoming, which is also smaller than us, have also pursued this area of financial services with the keenness that they have in recent years.

We are here because we are fighting for the global public good, and we are fighting for the human rights of our citizens. This committee has already expressed its concern about financial exclusion of the American population, persons who have been excluded here. Our people are no different. When we were growing up, opening a bank account was a part of our rites of passage in becoming an adult. Today, it is now a gargantuan obstacle for us to have our people do so given that businesses come into our region and it sometimes weeks or months just to open a bank account as individuals to live and as companies to trade and do business.

Our economies cannot function on their own. We do not make enough clothes, we do not produce our own food, we do not produce our own equipment, and, therefore, unless we are able to trade with the rest of the world, we are at risk of becoming financial pariahs. We are here because the listing process that has taken place, whether through the Financial Action Task Force (FATF), or the Organisation for Economic Co-operation and Development (OECD), or, further, as a result of actions taken for enhanced due diligence by those who take the listings from the FATF and the OECD, it means that those correspondent banks over the course of the last 10 to 12 years have made a judgment that we are simply too small, as I have just told you, in order to get involved because the enhanced due diligence means increased costs of regulation, and increased costs of compliance. And rather than do business with us, they say, thank you, but no thank you.

What it has meant is that almost every country in our region over the course of the last decade, with the exception of two or three, have had a loss of more than 30 percent of their correspondent banking relationships. The truth is that we have also seen others use alternative mechanisms, as the ranking member just appropriately referred to in his opening statement. And, therefore, what we face is a situation where the very thing that you set out to achieve, which is the avoidance of terrorism financing, the avoidance of money laundering on which we are all agreed, is likely to happen because you are driving people underground. There is no benefit in driving our citizens underground or making our countries uncompetitive, such that our economies are at risk of becoming underdeveloped or failed states. And we now have to determine whether this is capable of being a continued acceptable course of action.

We have been making noise for nearly a decade, and we want to thank this committee for hearing us today, because that noise cannot continue. And ironically, with the technological developments that have taken place, and as recent as the issuance of the digital yuan on which the Economist magazine wrote a column last week, there are options becoming available to countries to opt out of the SWIFT (Society for Worldwide Interbank Financial Telecommunications)system, and to find other ways of being able to transmit money to their citizens.

For us in this region, it is not yet here, but given long enough, nature abhors a vacuum, and we will find a way. And why should this matter to you? This is a country of immigrants. We have as many immigrants here as from Africa, Asia, Europe, all over. And you need to recognize that part of the pattern of being an immigrant is that when you are able to do better, you want to send money back home to those who have not been able to make the journey. When correspondent banking relationships are removed from our people, there is no longer the luxury of being able to do so, but the love doesn't stop. You don't stop loving your family. You don't want to stop sending back the money. And, therefore, you will find whatever mechanism you can to be able to do so.

Similarly, our economies require not just investment from local savings, but the attraction of foreign direct investment to survive. If we cannot keep our country safe, you already know in this country the spectacle of immigration from Caribbean countries. And you already have vigorous debates about what is acceptable and what is not acceptable, sometimes in ways that cause a little difficulty, too. If we want to be true to the declaration that we signed in Los Angeles, in the City of Angels, 3 months ago with respect to migration, then it is important that we create conditions where our countries can benefit and where our countries can have a level playing field in order to be able to achieve prosperity for our citizens who expect education, healthcare, and opportunities for trading.

We, the majority of our countries, also depend on tourism. What happens when your tourists come? What happens when your investors want to build hotels? This is the most nonsensical thing that we have seen in public policy. And why do we say that we are at risk of offending a human right and a global public good? Every citizen of the world ought to have the right to be able to have a bank account if they are to walk the streets without fear of crime, if they are to have the opportunity to save, if they are to have the opportunity to do as the capitalist system tells us we should do: to leverage our savings to be able to invest in order to grow our economy and to increase our wealth.

And every country in the world ought to be able to have access to affordable banking services to fuel trade and to foster and enable remittances. And in this entirely-globalized world that has come out of the bottle and can't go back in, there is no chance of putting the genie back in the bottle. What we do is force countries to find alternative means to trade.

Now, the SWIFT system sounds familiar. Why? In this committee, I am sure you have had a lot of discussion about who should be excluded from the SWIFT banking system in this year. And we know that the attempts to keep Russia out through sanctions, as you have done with other countries, simply has treated them as pariahs, but they have found ways to trade outside of the SWIFT banking system, too.

The reality also is that if you don't use this example to show you why this is an appropriate time to take different action, we will continue the injustice. And what do I mean by that? Russia didn't choose the Caribbean to hide its money. Russians didn't choose the Caribbean to hide its money. They chose the metropoles. They chose London, and New York, and Switzerland, and Luxembourg. And you only have to, as Tom Cruise told us in that famous movie, "Follow the money." Where has the money gone? It hasn't come to the Caribbean. And what we have is listings from the Financial Action Task Force that are perhaps well-intentioned, but are focused on process and form and are not focused on substantive prosecution of money laundering. That is the equivalent of saying that I am more interested in whether you adhere to rules than in finding where the money launderers are.

When you wanted to find the money launderers with respect to Russia, you didn't come to the Caribbean. You went to London. You went to New York. You went to Zurich. You went to Luxembourg. And I say this because there has to be a fundamental injustice in the system that puts on a list not Luxembourg, not the United States of America, not the United Kingdom, but perhaps Jamaica, Trinidad, Ghana, Barbados, all of which were put on a list, not even because we were having substantive money laundering there, but because in 2020, there was a determination to change the criteria by which we assess countries, looking at the definition of money supply from M2 to M3.

Now, for most of my constituents, that sounds as though we are playing a game, but that reality of changing the definition of money supply led to the listing of our countries. And what did it mean? An investor wanting to come to Barbados from Europe goes into a bank and says, "I want to transfer X million dollars for an investment." The bank says, "Oh, Barbados, no, we have to do enhanced due diligence because they are on a list, or Belize, we have to do enhanced due diligence." When that happens, they say, "But guess what? The enhanced due diligence is too costly for us. You need to go and find another bank."

It doesn't only happen with de-risking of institutions. It also happens with categories of business. So, you have bankers saying to people who trade gold, oh, you can't bank with us anymore. Come for your millions of dollars. Where are they going to carry it? How does that enhance the opportunities for crime? How does that enhance human insecurity? People who trade in casinos, do you believe that the owners of casinos in Las Vegas keep their money in a safe or do they keep it in a bank?

In the Caribbean and Trinidad where the casinos and then the rest of us, they tell the people who have casinos and slot machines, you can't bank in a bank anymore, in spite of the fact that we still have correspondent banking relationships. Why? Because to keep the remaining relationships that we have, they go overboard with the level of compliance and regulatory compliance that make us now as countries uncompetitive and make the conduct of certain businesses prohibitive. This can't be fair, and if it is not fair for your people to be excluded financially, then we say equally it is not fair for their family in the islands and in the other countries from which they come to be excluded financially. This is a global public good that we must protect, and this is a human right that we must protect. And I want to thank this committee for seeing us today, for hearing us, and for feeling us because far too often, that has not been done.

The last point I will make is this. Do not let this be recorded as an act of unconscious bias, and why do I say so? Look at the list of countries who are listed, and you will see that they are almost all former colonies and people of color. And look at the countries who, in spite of being able to open a bank account within hours in Delaware or Wyoming, within hours in Luxembourg or Zurich, and they remain off of these lists that speak about the risk to money laundering, and look and see where the divide comes. I believe that this committee has a keen eye for fairness and equity, and all we ask today is for a level playing field.

One of the solutions we will leave you with is that the Treasury ought to be truthful to its mandate. It says that it wants to be risk-sensitive. If it wants to be risk-sensitive, then it needs to focus on where the money is rather than creating rules that act as a proxy to money laundering or terrorism financing, and it has found the answer, even if fortuitously or serendipitously this year, by following the money with the Russian sanctions.

I thank you and I pray that we can use technology, communication, sharing of information, but above all else, fairness and transparency to ensure that our people are not further punished from being able to participate in their lives, through their economies, through their savings, and with their families across borders and businesses. Thank you very much.

[The prepared statement of Prime Minister Mottley can be found on page 61 of the appendix.]

Chairwoman WATERS. Thank you so very much, Prime Minister Mottley.

Now, without objection, I would like to submit statements for the record from the Caribbean Community Secretariat, the Government of Antigua and Barbuda, and MoneyGram International, Incorporated, that echo many of the things that Prime Minister Mottley stated in her testimony.

Without objection, it is so ordered.

I now recognize myself for 5 minutes for questions.

Prime Minister Mottley, thank you again for your testimony on this vexing issue of bank de-risking. In your testimony, you explained that the international community, including the United States, tends to incorrectly perceive the volume and impact of financial crime that moves through the Caribbean as compared to other countries like Switzerland, the United Kingdom, and even the United States. The European Union has high-profile examples of years-long anti-money laundering failures, such as Danske Bank, through which Russian oligarchs, including Russian President Putin, have laundered billions of dollars. And yet, instead of looking inward, it is Caribbean nations and non-sovereign territories that the United States blacklists for money laundering or tax reporting deficiency.

You have argued that such blacklists and similar reports are one reason why the Caribbean is incorrectly perceived by correspondent banks to be riskier. For example, the United States Department of State prepares an annual report with input from the listed countries called the International Narcotics Control Strategy Report, or INCSR. The purpose of this report is to describe the efforts to combat all aspects of the international drug trade, including money laundering and financial crimes.

INCSR is an important and useful report, but it only provides negative information about listed nations without describing their efforts to improve their ability to fight financial crime. This seems to not provide a full picture of the actual risks that exist. That is why I proposed H.R. 8798, the INCSR Improvement Act, which would amend the law to require INCSR to include examples of anti-money laundering improvements made in the list of countries. I believe that including such information will also be useful for the Congress in understanding the countries whose activities are being reviewed.

Prime Minister Mottley, can you please comment on the effects that international blacklists and reports like INCSR have had on perception about the banking risk in the Caribbean, especially in terms of how correspondent banks incorporate that information in their risk evaluation and decisions about whether to offer services within a listed country? And specifically, can you comment on my proposal to make changes to the INCSR report?

Ms. MOTTLEY. Thank you very much for that question, and it is very appropriate. The reality is, as I said, the listing has been recognized by the Bank of International Settlements as perhaps the greatest reason why correspondent banks leave and remove their relationships, and, therefore, these lists are deleterious. We believe that if we can move these lists off, we are in a position to be able to at least have a better chance to make the case that the substantive concerns that we all have to fight crime are being met.

The reality is that the State Department's report—and once again, we have been complaining for years—is prepared by junior officers. It is not robust, it does not allow us a right of response, and it does not take into account when improvements have been made during the course of the year. This is not an exam. This is our life, and this is real for our people. When banks remove themselves and say they are not doing business, and an investor has a choice between a country in the Caribbean or a country elsewhere where he can seamlessly move his investments, he is going to go elsewhere.

And that is why we say that these reports have a disproportionate consequence in excluding us and making us financial pariahs and making us uncompetitive. And we feel that if you can pass legislation that: one, includes a right for us to respond; and two, since we live in a world of real time, if we have improvements, they ought to be taken in real time rather than waiting for the next year's report in order to take account of the improvements that have been made by countries. Why? Because in the course of the year, that country can lose 5 percent of its economic activity, 7 percent, 2 percent, all as a result of its failure to be able to attract investment.

And equally, what I haven't spoken about is the millions of dollars that we have to spend as a small state to try to satisfy those considerably-larger questionnaires that exist in circumstances where we know that the money isn't in us, and that it is not us where the money launderers are hiding their money in plain sight. But you are coming to us to give yourself a sense of comfort, and that is our concern with these lists.

And secondly, when we comply with the list, what happens? The goalpost has moved, and a new list comes out with different concerns, and we have seen it whether in terms of money laundering and terrorism finance or in terms of tax transparency with the OECD. And that is why if you go back, we are continuously on these lists, facing the consequences of that withdrawal. Thank you.

Chairwoman WATERS. Thank you. I agree with you, Prime Minister. And as we heard several months ago at the roundtable in Barbados, and as we are likely to continue to hear today, the incompleteness of these international reports can have a profound impact on whether a correspondent bank decides to cut off all business to a country.

I now recognize the ranking member of the committee, the gentleman from North Carolina, Mr. McHenry, for 5 minutes for questions.

Mr. MCHENRY. Thank you, Madam Chairwoman, and thank you, Prime Minister, for being here. This is an important issue, but in de-risking, we want to make sure that the knock-on effects of this are not so severe that we actually go against our common interest here. But the way this de-risking is carried out is because of jurisdiction, or industry, or an area is deemed to be high risk for money laundering. That is at least what the financial regulators will say, what these institutions that are moving out of territories will say.

My question to you is just a very direct one. What is your government or your country doing to counter that perception, or what they would say is fact, but I think we would say is perception. What are you doing to counter that perception?

Ms. MOTTLEY. Thank you. We have had to pass substantive laws to deal with these issues since 9/11. I was attorney general when 9/11 happened. I was around when Resolution 1373 and all of those other resolutions were passed when the U.S.A. Patriot Act was passed. The U.S.A. Patriot Act has not stopped money laundering in this country. The U.S. Patriot Act has not stopped money laundering in Europe. You have seen the evidence of it this year as you have gone after the oligarchs and as you have put sanctions on others.

At the same time, our country has had to divert money away from social spending and critical infrastructure spending in order to ensure that we do not have our banks cut off from the rest of the world. And to that extent, that is why my citizens have to face 4 weeks or 5 weeks to open a bank account as a young kid with no background of any kind of problems in any society because you are now coming into an adulthood.

Similarly, if you decided to have a company here, to try to invest in Barbados, more often than not, it will take 4 or 5 weeks to open an account. If you go to Delaware, you can open it up within matter of hours, in a twinkle of an eye. If you go elsewhere in Europe, in a twinkle of an eye. In spite of all of those things, we have had to spend this money just to be able to not be level, but to come close to having a chance of having economic activity.

Mr. MCHENRY. So, what are you using? Are you using technology to speed up that process?

Ms. MOTTLEY. We are using technology. In Barbados, we have just introduced a national digital identity verification card, and that is to help us expedite the process in spite of what else we are fighting for in terms of our advocacy.

Mr. MCHENRY. But you are talking about a digital identification card?

Ms. MOTTLEY. Digital identity card.

Mr. McHENRY. We don't have that in the United States. Explain to me what that is.

Ms. MOTTLEY. A card that helps you to validate who you are digitally to give you access to other services so that the banks can take a chance on you in a more credible way, but that costs us millions of dollars to do. In the same way equally, our banks are using a metric, which is, in fact, far more rigorous than yours. You have a metric of $10,000 for money laundering. Our metric is the equivalent of $5,000, so that every transaction over $5,000 has to be able to be monitored and examined. And the bottom line is that in every instance, we are doing—I say this with Madam Chairwoman, like women, we are doing twice as much as you to be considered half as good as you.

Mr. McHENRY. I have no follow-up because I, in fact know it is true, sadly, but I also know the effects, which is that you are working twice as hard and actually are twice as good, perhaps more. So along those lines, you are taking active concerted efforts to address these concerns, and you are working actively to do that. I think that is an important message.

And Madam Chairwoman, thank you for holding this hearing because it does bring up a big issue that we talked about a couple of Congresses ago domestically, but we need to talk about in terms of our trusted trading partners. In a complicated world, we need to make sure that our closest countries are our closest friends, and we need to treat them like our closest friends.

And I think for too long, we have thought of many of our neighbors to the South as great places to go visit without thinking, we need a trading relationship, not a visiting relationship, and we need to change this mentality of our closest neighbors, who are actually deeply moored with us and in our economy, and that is an exchange. That is not a one-way street. It is a two-way street. We need to make sure it is done that way. So Madam Prime Minister, thank you for being here. Thank you for your testimony.

Ms. MOTTLEY. If I may, the reality is that we are family, and apart from being family, there are opportunities that can exist to improve your conditions and our conditions. But nothing has happened between the U.S. and the Caribbean since the passage of the Caribbean Basin Initiative Act more than 40 years ago. And if we don't create the opportunity to expand the trade, which now stands at $35 billion, with which you have a trade surplus of $12 billion, there is far more work that can be done, far more investment that can be done. And there are issues. For example, even as we fight the issue of fertilizer, Trinidad has surplus capacity on natural gas and fertilizer, but they can't get it here because of other issues that you have resolved for Europe, and you have resolved for Chevron, but not for Trinidad and Tobago. There are a number of issues that I believe again—

Mr. McHENRY. Okay. This is also a trading relationship conversation, I see.

Ms. MOTTLEY. Yes, it is more than trade, and we are family there too.

Mr. McHENRY. Yes.

Ms. MOTTLEY. But basically, what really is happening is that we are not having the opportunity to do what we should be doing:

trade with each other substantively and to create and work together collaboratively to fight crime. And we have that relationship with Southern Command. We have that relationship with other agencies in this country, but it is almost as if the left hand and the right hand don't know what the other is doing.

And all we are asking you to do in this committee is to bring clarity and to have a sensitization that if Treasury wants to really fight crime and fight money laundering, do not drive the transactions underground by forcing us to find alternative means to trade and to send money to each other. And whether it is a digital one or whether it is the unregulated crypto exchanges, or whether it is buying jewelry, people will find ways to send remittances and will find ways to continue to trade because we do not produce all that we need in order to live.

Mr. MCHENRY. Thank you.

Chairwoman WATERS. Thank you, Mr. McHenry, and I would like to thank our distinguished witness for her testimony today.

Without objection, all Members will have 5 legislative days within which to submit additional written questions for the Prime Minister through the Chair, which will be forwarded to the witness for her response.

We will now take a brief recess to bring forward our second panel of witnesses. Thank you very much.

[brief recess]

Chairwoman WATERS. The committee will come to order. I would like to welcome our second panel of distinguished witnesses to the committee: Mr. Wazim Mohamed Mowla, the assistant director and lead of the Caribbean Initiative at the Adrienne Arsht Latin America Center, Atlantic Council; Ms. Wendy Delmar, the CEO of the Caribbean Association of Banks; Mr. I. Wayne Shah, the senior vice president of financial institutions and the head of the Caribbean region at Wells Fargo Bank, as well as the executive director of the Financial and International Business Association; Mr. Amit Sharma, the CEO, founder, and director of FinClusive; and Ms. Liat Shetret, the director of global policy and regulation of Elliptic.

You will each have 5 minutes to present your oral testimony. You should be able to see a timer that will indicate how much time you have left. I would ask you to be mindful of the timer so that we can be respectful of everyone's time.

And without objection, your written statements will be made a part of the record.

Mr. Mowla, you are now recognized for 5 minutes to present your oral testimony.

STATEMENT OF WAZIM MOWLA, ASSISTANT DIRECTOR, CARIBBEAN INITIATIVE, ADRIENNE ARSHT LATIN AMERICA CENTER, ATLANTIC COUNCIL

Mr. MOWLA. Good morning, Chairwoman Waters, Ranking Member McHenry, and distinguished members of the committee. It is my privilege to address you this morning on the impacts of de-risking in the Caribbean and strategies for ensuring financial access.

First, I congratulate the committee for prioritizing the withdrawal of correspondent banking relations and, by virtue of holding this hearing, underscoring your commitment to addressing this issue, one that is critical to both the Caribbean and the United States. I would also like to note that it was an honor to accompany Chairwoman Waters to Barbados earlier this year and participate in the Caribbean Financial Access Roundtable in which the issue of de-risking was raised.

Before I begin, I would also like to acknowledge the much-needed comments and insights from the Honorable Prime Minister Mia Mottley of Barbados, as well as the other witnesses who are joining me today, including Wendy Delmar and Wayne Shah, who are both part of the Atlantic Council's Financial Inclusion Task Force.

Members of the committee, as you have heard today and will continue to hear, the withdrawal of correspondent banking relations, or de-risking, is having a significant impact on the health, functioning, and development of Caribbean economies. Financial institutions list the Caribbean as the most effective region globally, with some countries losing close to half of all correspondent banking relations over the past decade. De-risking has adverse effects on key economic sectors including tourism, remittance flows, and access to international trade, finance, and credit. To put it simply, de-risking is effectively cutting the Caribbean off from the rest of the world, bringing any means of economic development and resilience to a halt.

Because of the extreme vulnerabilities these countries face, they are in a constant state of economic survival, consistently depending on global finance to rebuild after hurricanes to attract foreign investment into emerging industries, and whose citizens rely on the imports of food, fuel, and goods to maintain the quality of life. All of this is only possible if these countries have access to correspondent banking. And while de-risking has severe impacts in the Caribbean, the United States, its national security, and its interests are not spared.

First, de-risking limits Caribbean countries' ability to access the U.S. dollar. This presents a challenge for U.S. agencies as it is counterproductive to addressing money laundering concerns if businesses and individuals are forced to use alternative currencies or avenues to transact payments. Often, this can become a place for criminal networks to hide illicit flows, making it more difficult for U.S. agencies to combat them. Here, there is a clear national security risk. Because of the Caribbean's proximity to countries that house illicit actors, such as Venezuela and Cuba, the region is then exposed to becoming the future hub for criminal financing if de-risking goes unaddressed.

De-risking also limits U.S. economic influence. U.S. companies seeking to shorten supply chains near shore to the region are likely to face barriers such that they cannot pay service and product suppliers. For companies looking to invest in emerging industries, such as the energy markets of Ghana, Trinidad and Tobago, and Suriname, correspondent banking will be vital to ensuring that the U.S. private sector is able to compete for contracts. Further, continued de-risking and loss of access to the U.S. dollar presents an opportunity for Caribbean governments and financial institutions to seek new or strengthen existing relationships abroad, notably with China.

While Caribbean governments and people rely on the U.S. dollar, it is not the only internationalized currency. While the euro is an alternative, Caribbean governments face similar de-risking challenges with banks in the European Union. The result is an opportunity for the Chinese RMB and its banks to strengthen ties with the region. The draw of new banks and RMB usage from China is likely to be attractive for most Caribbean countries and can even influence Taiwan's allies in the region. At present, 5 of Taiwan's 14 remaining allies are CARICOM members. Except for Haiti, these countries have each lost more than 30 percent of the correspondent banking counterparties since 2011. If the severity and frequency of de-risking rises in the region, this can be an added incentive for Taiwan's allies to pursue a switch in diplomatic recognition.

Members of the committee, I urge you to take legislative steps to address de-risking in the Caribbean to promote financial inclusion and safeguard U.S. interests. Never has there been more of an appetite for the United States and the Caribbean to expand cooperation and strengthen their partnership, but doing so will require tangible and decisive action. The INCSR Improvement Act is one such example, which will help Caribbean financial actors and government leaders annually underscore actions taken to address money laundering, drug trafficking, and financial crimes, and the Caribbean Stakeholders Engagement Act is another, which will ensure that those that are most affected by de-risking have a seat at the table.

Members of the committee, I speak to you today as a Caribbean American, someone who has a vested interest in the well-being, prosperity, and security of both the Caribbean and the United States, and I can clearly and sincerely state that correspondent banking underpins the core of the U.S.-Caribbean economic relationship. It has an impact, not just on Caribbean citizens, but on U.S. citizens as well. Taking actions today and in the future can ensure that we as neighbors, as Americans and Caribbean citizens, can build a future that is safe and prosperous for everyone.

Thank you once again for the honor and the opportunity to appear before the committee today. I look forward to answering your questions.

[The prepared statement of Mr. Mowla can be found on page 75 of the appendix.]

Chairwoman WATERS. Thank you. Next, we have Ms. Wendy Delmar, who is the CEO of the Caribbean Association of Banks.

STATEMENT OF WENDY DELMAR, CEO, CARIBBEAN ASSOCIATION OF BANKS (CAB)

Ms. DELMAR. Chairwoman Waters, Ranking Member McHenry, and distinguished members of the committee, good morning. I am honored for the opportunity to shed light on a matter that may be deemed the proverbial thorn in the side for banks and financial institutions in the Caribbean. As a Caribbean national and career banker, the onslaught of de-risking activity, and its resultant adverse impact on the banking industry and economies of the region, has been both disheartening and deeply concerning.

As chief executive officer of the Caribbean Association of Banks (CAB), I am proud to state that the CAB was the first regional organization to sound the alarm as early as 2015 relating to de-risking activity in the Caribbean. Since then, we have worked assiduously to bring to the forefront the challenges faced by the region resulting from the loss of correspondent banking relationships, while concurrently striving to identify and execute possible solutions.

It is agreed that prior to the increase in regulatory requirements aimed at addressing money laundering and the financing of terrorism, banks and other financial institutions within the Caribbean enjoyed mutually-beneficial correspondent banking relationships with the United States' correspondent banks. However, as noted by Ian De Souza in 2017, in a research paper commissioned by the CAB on the unintended consequences of de-risking, the scaling up of efforts related to anti-money laundering and combating the financing of terrorism ultimately resulted in a deteriorated cost-benefit position for the business of Caribbean banks and other financial institutions. Yet, regrettably, and quite candidly, the current arrangements through which the international financial system has chosen to relate to Caribbean banks and other financial institutions has rendered the region disproportionately dependent on correspondent banking services, thereby exacerbating the adverse effects of de-risking.

In my written submission, I have developed the foremost areas of concern related to the matter. Noting however the time restrictions for this morning's hearing, I will provide a brief summary.

The Caribbean is comprised primarily of small island developing states. As such, foreign direct investment is significant to the gross domestic product of Caribbean economies. De-risking perpetuates the perception of the region as high risk, which negatively impacts investor appetite. The likely resultant decline in foreign direct investment (FDI) has a multiplicity of ramifications from the macro to micro economic levels.

Moreover, access to international financial markets is paramount for Caribbean jurisdictions given that most countries are, in fact, net importers. Therefore, the availability and access to goods, from grocery store items to vehicles, is dependent on well-functioning correspondent banking relationships. At the height of de-risking activity, Belize, for example, lost nearly all correspondent banking relationships. Wire transfer services, the processing of credit card payments, and the clearing of checks issued by United States banks were unavailable. In a jurisdiction heavily dependent on tourism, the ramifications of the previous would die off.

Additionally, banks and other financial institutions within the Caribbean continue to contend with significant increases in operational costs, driven almost primarily by compliance initiatives. This is representative of one of the most deleterious unintended consequences of de-risking, which is the burden inadvertently placed on all banks within the region to discredit the relentless perception and perpetuation of the region as a high-risk jurisdiction.

In this regard, I draw attention to the annual International Narcotics Control Strategy report, previously mentioned by PM

Mottley. Though this may not be the committee responsible for the report, I wish to commend Chairwoman Waters for her interventions resulting in proposed amendments to the text of the report, which, if successfully adopted, will increase the validity of the report, and hopefully result in a more factual and less disparaging representation of the Caribbean.

With the foremost in mind, I offer the committee the following strategies for improvement: one, the development and implementation of common and preset international compliance standards; two, the consideration of correspondent banking services as an economic and humanitarian good; three, the support of a regional approach to improve the cost-benefit position of correspondent banks; and four, to improve the provision of information to inform the International Narcotics Control Strategy report.

Ladies and gentlemen, I thank you for the opportunity again to present to you this morning, and I am open to any questions that you may have.

[The prepared statement of Ms. Delmar can be found on page 56 of the appendix.]

Chairwoman WATERS. Thank you, Ms. Delmar. Next, we will go to Mr. Shah. You are now recognized for 5 minutes to present your oral testimony.

STATEMENT OF WAYNE SHAH, SENIOR VICE PRESIDENT, WELLS FARGO & COMPANY; AND VICE CHAIR, FINANCIAL AND INTERNATIONAL BUSINESS ASSOCIATION (FIBA)

Mr. SHAH. Chairwoman Waters, Ranking Member McHenry, and members of the committee, good morning. I am Wayne Shah, senior vice president of the Financial Institutions Group at Wells Fargo and Company and a board member on the executive committee of the Financial and International Business Association (FIBA), of which Wells Fargo is a longstanding member. I appreciate the opportunity to be here today and I look forward to sharing with you the many ways in which Wells Fargo is working to support our correspondent bank customers in the Caribbean.

I will speak to you today in two capacities: first, I will discuss Wells Fargo's activity in the Caribbean; and second, I will discuss FIBA's efforts in this area. I work for Wells Fargo Corporate and Investment Bank and support both domestic and international financial institutions through a dedicated industry coverage team. Wells Fargo has provided strategic correspondent banking services to the Caribbean banks for more than 50 years. Our commitment to the region's growth and development is underscored by our market share and the number of countries where Wells Fargo services are available. Wells Fargo provides correspondent banking services to banks at the regional, head office, and country level. Today, we provide services to over 20 countries in the region.

Following the 2008 financial crisis, the process known as de-risking began to show up in the Caribbean. De-risking refers to the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid risk rather than manage it. In 2007, Wells Fargo and FIBA created the Caribbean Roundtable to highlight and discuss pressing matters for the Caribbean banking community. FIBA ultimately attributed de-risking to a change in perception that the Caribbean banks have become high risk. According to FIBA, de-risking seemed to impact smaller banks to the greatest extent. These banks were no longer able to access international markets, execute foreign payment and trade services, or support cross-border credit cards. However, during this time, banking services necessary to support the region continued to be available through larger, unaffected financial institutions.

Instead of exiting banks, Wells Fargo embarked on a significant effort to work with respondents on enhancing their Bank Secrecy Act/Anti-Money Laundering (BSA/AML) programs. Wells Fargo's focus was to understand, improve, and align risk management objectives. Wells Fargo established and funded an annual Caribbean conference whose purpose was to create a forum to work with Caribbean banks in navigating change. The conference is focused on building a better, safer, and financially-inclusive Caribbean ecosystem.

As a FIBA board member, I would like to also take a few minutes to talk about the contributions FIBA made in response to de-risking in the Caribbean. Built on a legacy that spans over 40 years, FIBA is a non-profit trade association, and an international center for financial excellence. Their membership includes the largest financial institutions from Europe, the United States, Latin America, and the Caribbean. FIBA is recognized by the financial services industry, regulators, and law enforcement as a center of excellence with deep knowledge and expertise in AML Compliance, and high-level education and training programs.

In 2009, FIBA first raised concerns about the potential loss of support for correspondent banking in the Caribbean. Over the next several years, FIBA invited stakeholders from Caribbean governmental agencies, Caribbean financial institutions, the U.S. Treasury Department, and U.S. regulatory agencies to debate and discuss potential solutions. To date, FIBA could not find any empirical evidence to believe that Caribbean banks had lesser abilities regarding BSA/AML. In fact, FIBA's view is that the Caribbean banks that remain in the market have invested heavily in BSA/AML compliance and risk management measures.

Caribbean banks are also currently highly compliant with international guidelines and industry best practices. In FIBA's opinion, the era of de-risking small Caribbean banks has long been over. However, many challenges remain that still jeopardize financial inclusion for the Caribbean. These include: one, making sure history does not repeat itself and de-risking does not affect the larger Caribbean banks; two, encouraging correspondent banks to return to the region; three, establishing a view that the Caribbean is a region of safety and soundness for financial services; four, encouraging independent country and counterparty risk analysis; and five, calibrating regulatory mandates and addressing unintended consequences of legislation and regulations.

On behalf of Wells Fargo and FIBA, thank you for letting me speak today, and I welcome your questions.

[The prepared statement of Mr. Shah can be found on page 81 of the appendix.]

Chairwoman WATERS. Thank you, Mr. Shah. Mr. Sharma, you are now recognized for 5 minutes to present your oral testimony.

STATEMENT OF AMIT SHARMA, CEO & FOUNDER, FINCLUSIVE

Mr. SHARMA. Thank you, Chairwoman Waters, Ranking Member McHenry, and the distinguished members of the committee. I am honored by your invitation to testify before you today. I look forward to sharing my views on the impacts of de-risking to our national, international, and economic security, as well as the capabilities of new technology and innovations happening in the traditional and non-traditional financial services industry, in particular as they represent many solutions to de-risking as well as the inherent contents of financial system integrity.

By way of background, I am the CEO and founder of FinClusive. We are a hybrid financial and regulatory technology company that connects traditional banking with blockchain-enabled payments and virtual asset networks. And we do this by providing a full stack embedded anti-money laundering set of capabilities, bringing a number of integrations globally for Know Your Customer (KYC) transaction monitoring, analytics, digital identity solutions, and legal entity identifiers, all to provide a utility for Know Your Customer, AML, and other financial crimes compliance protocols.

My colleagues here today have provided a thorough definition and description of de-risking itself and the manner in which financial exclusion in the Caribbean consequentially is linked to the growth and continued uncertainty of growing anti-money laundering obligations over many, many years. And I wish to focus my oral statement on the attendant risk of de-risking and the uncertainty that we believe provides more financial solutions than detriments to the financial services industry.

First, it is important to note that financial excluded or underserved is disproportionately the vulnerable parts of our society from low/moderate income to global poor, those lacking in financial and credit history, jurisdictions labeled by many governments, including our own, and global standard setters like the Financial Action Task Force as being particularly weak in anti-money laundering or consequently working through corruption issues, as well as certain types of activities like money services businesses, remittances and trade finance, mobile and web-based applications, and, increasingly, those that are in the financial technology and the blockchain industry that are increasingly looked at by traditional institutions as inherently higher risk.

The importance of financial inclusion cannot be overstated, and much of this has been discussed today, but, in fact, the remittances and economic consequences for just global trade also cannot be overstated. In fact, over 3 times official development assistance is happening through global remittance flows and many times, for certain jurisdictions, that is one-third or more of their GDP.

To formulate solutions to de-risking and financial exclusion, we must take note of a couple of really important trends, and the first is the recognition that there continues to be an exponential increase in non-bank, technological, and web-based applications for finance and banking. And these are very important peer-to-peer transactions, virtual asset level transactions, and, alike, are increasingly available to many who just do not have access to traditional financial services.

Secondly, this growth has given a lot of regulatory agencies pause because of the uncertainty and unknown considerations associated with technologies that just look and operate differently from traditional financial services, banking, and payments.

And finally, this growing body of regulations is, in fact, causing significant challenges for new and emerging entrants that are trying to provide financially-inclusive opportunities that then have to put policies, procedures, licensing, and other applications in place that are often costly and burdensome.

There are several important areas where solutions are being orchestrated within the context of the Caribbean and, indeed, globally in the service of financial inclusion and addressing de-risking. Several of them include enabling marginalized communities to be furnished digital wallets directly so that virtual assets can be funded directly into them, and to provide them access to vital economic resources to pay between each other and merchants providing vital assistance.

Linking those digital wallets to accounts provides a gateway between fiat stores of value and virtual assets. Governments themselves are issuing their own digital currencies, which can automate financial access, and, in fact, provide official assistance and other necessary services. Globally, donors are increasingly using virtual assets to provide needed assistance directly to recipients in need, and also issuing digital identity credentials that can be served as not only global Know Your Customer (KYC) utilities, but to verify and validate individuals and the transactions that they undertake.

In sum, we must look at these tools as not only driving financial inclusion activities, but inherently, these very attributes of the technologies serve to strengthen the financial crimes compliance and anti-money laundering objectives themselves. While financial innovation continues unabated, we must stop with this false binary choice of a system that may provide financial access versus threaten financial system integrity, because inherently they are linked.

I thank you again for your time, and I look forward to your questions.

[The prepared statement of Mr. Sharma can be found on page 86 of the appendix.]

Chairwoman WATERS. Thank you, Mr. Sharma. Next, we will have Ms. Shetret. You are now recognized for 5 minutes to present your oral testimony.

STATEMENT OF LIAT SHETRET, DIRECTOR, GLOBAL POLICY AND REGULATION, ELLIPTIC

Ms. SHETRET. Good morning, Chairwoman Waters, Ranking Member McHenry, and distinguished members of the committee. It is my privilege to address you at today's hearing on the topic of de-risking. Thank you for prioritizing this important topic. I will focus my testimony on why de-risking happens, the consequences of de-risking, and how technological innovations can help minimize the practice of de-risking.

My name is Liat Shetret. I am the director of global policy and regulation at Elliptic, the global leader and provider of anti-money laundering compliance solutions to virtual assets businesses and regulators globally for nearly a decade. We equip financial institutions, crypto asset businesses, law enforcement, and regulators with the tools and insights they need to manage risk, including, for example, to identify, assess and act upon illicit and criminal crypto transactions recorded on the blockchain. Elliptic makes sense out of blockchain data and identifies trends and typologies that help our customers understand and evaluate the risk exposure and make risk-based decisions.

De-risking is not a new issue. In 2015, I co-authored a report commissioned by Oxfam U.S., entitled, "Understanding Bank De-Risking and its Effects on Financial Inclusion." In that report, we explored the drivers and responses to de-risking, highlighted case studies of financial access, and provided recommendations for banks, regulators and bank customers who have been de-risked.

Not much has changed in terms of the complexity and detriment of the de-risking problem. However, the urgency of addressing de-risking of correspondent banking relationships, specifically in the Caribbean and other regions, is significantly heightened. We have heard about this at length in testimonies before mine. One piece that has not been mentioned is the stark gender gap in financial resilience in the Caribbean, where 56 percent of men can reliably access emergency money, but only 39 percent of women report being able to do so.

While de-risking practices have not been localized in any particular population, community, or industry, in recent years there has been an aggregation of results best described as a trend towards de-risking of sectors, including correspondent banks and specific financial corridors and regions. These account closures have had a ripple effect on financial access for individuals and businesses who rely on access to financial services with regional and national security implications. Financial institutions have significantly scaled back their risk appetites. These declining risk appetites, coupled with rising global scrutiny of anti-money laundering and countering the financing of terrorism rules, are the most commonly-cited reasons for de-risking.

Digging deeper, we note that underlying the practice of de-risking is the assumption that the affected customers present a higher risk of utilizing their bank accounts as a medium for raising, moving, and storing funds that are somehow tainted by illicit activities, such as money laundering, terrorist financing, or tax evasion. Specifically, correspondent banks which provide back-end services such as check clearing, foreign exchange trading, and fund transfers on behalf of other financial institutions have been identified as a key vulnerability in Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) regimes. In short, the risk is simply not worth the reward.

De-risking is an issue that impacts entire markets. All invested stakeholders, bank regulators, and bank customers and clients appear to be acting rationally and in their own best interests. However, in doing so, they have created unintended consequences for market integrity, financial inclusions AML/CFT objectives, and, worryingly, have compromised national security interests. A lack of structured and systemic response to the issue of de-risking is perpetuating the challenge of regulatory arbitrage, which is the practice of utilizing more favorable laws in one jurisdiction to circumvent less-favorable regulation elsewhere.

International standards urge institutions to adopt a risk-based approach. Regulators proactively advise financial institutions to assess their policies and allocate resources according to their unique risk profiles and risk exposure. Although this approach is designed to allow for flexibility, it also introduces ambiguity. Inappropriate risk avoidance has replaced effective risk management. Rather than reducing the risk of criminal activity in the global financial sector, de-risking potentially increases systemic vulnerability.

How can these objectives be balanced? De-risking is a problem of exclusion that is remedied by inclusion, specifically the inclusion of technology actors. For the Caribbean, convening an action-oriented task force or committee of affected parties, including financial institutions, regulators, and trusted members of the private sector, such as tech companies, will bring innovative solutions to historically-challenging problems.

Congress should explore legislation to facilitate the acceleration of digital identification, offering clarity and certainty to a liquidated banking concept. As the digital economy has evolved, the need to update and expand the definition of compliance concepts such as customer due diligence and Know Your Customer rules must also evolve. New legislation should explore KYC elasticity, the idea that these rules can be expanded to fit economic development and security realities straddling digital and traditional markets.

Congress should expedite the thorough exploration of blockchain-based technology solutions that enhance U.S. dollar dominance globally, including a stablecoins framework and central bank digital currencies (CBDCs) which will ensure that market efficiency, privacy concerns, and interoperability with economic blocks, such as their Caribbean counterparts, will be considered.

Many challenges remain in addressing the balance between financial integrity and inclusion. However, there are also many opportunities to address these issues by operationalizing public/private sector initiatives that address concepts such as identity and transaction monitoring. Moving into a digitized economy gives banks the opportunity to innovate, manage, and mitigate risks effectively. Technology innovations, such as blockchain, serve as an enabler to every stakeholder involved in a de-risking conundrum.

On behalf of Elliptic, thank you for the opportunity to speak here today, and I welcome your questions.

[The prepared statement of Ms. Shetret can be found on page 100 of the appendix.]

Chairwoman WATERS. Thank you, Ms. Shetret. I now recognize myself for 5 minutes for questions.

Ms. Delmar, as the CEO of the Caribbean Association of Banks, you represent the collective interest of banks domiciled in the Caribbean to strengthen the regional banking sector. I understand it can take weeks or even months to open up a bank account or to get transactions approved through the correspondent banks. What are the reasons given by the correspondent banks to the respondents or from correspondents to the individual and entity customers with such delays?

Ms. DELMAR. Thank you for the question. As it would have been submitted in one of the exhibits by the Caribbean Association of Banks for our discussions this morning, what we have found is there is very little to no communication specifically as it pertains to the closure of respondent banks by the correspondent. As far as the opening of accounts, the banks have now been forced into a position of extreme monitoring, as I tend to put it, where we are spending inordinate amounts of time trying to ensure that, from a KYC perspective, the customers meet the regulatory requirements necessary to ensure that we are operating above the line or within compliance with regulatory standards. It is not, however, a situation where the correspondent bank necessarily dictates what is required for the opening of accounts, but rather, the respondent banks' attempts at ensuring that every transaction that stems from these accounts will be deemed appropriate by the correspondent, thereby not jeopardizing the relationship with the correspondent banks.

Chairwoman WATERS. Could you take a moment to tell me what steps your member banks have taken to address the concerns of the correspondent banks in order to attract these services? Have any of these efforts been successful, and why or why not?

Ms. DELMAR. Okay. As far as the relationship with the correspondent banks is concerned, the respondent banks at this stage have spent inordinate amounts of money in ensuring that we have invested in technology so that there is easy and significant monitoring of transactions through the processes that come in. We have also ensured that the relationships are maintained with the correspondent banks by being able to respond to questions that may come back to us, depending on the transactions that will be processed through the correspondent banks in the very shortest periods of time. As far as the information coming back, we have not seen any reentrance of correspondents who have left the banking region, aside from one more recently, which was really spurred by an increase in the volume of transactions that we would have seen being processed, primarily because of an acquisition that was made of an international bank, which, of course, then drove up the amount or the volume of transactions being processed.

Again, the question on our end remains whether it is a situation of noncompliance from an AML perspective, or whether or not it holds true that because of the size of the transactions being processed, as well as the volume of transactions being processed, that we are being penalized from ensuring that these correspondent banking relationships remain strong.

Chairwoman WATERS. Mr. Shah, in April of this year, Prime Minister Mottley and I co-hosted the Caribbean Financial Access Roundtable, which brought together heads of state, Members of Congress, financial institutions, industry associations, think tanks, international organizations, and other stakeholders to advance concrete solutions to this continued problem of de-risking in the Caribbean. One idea that I raised, which received a great deal of support from across the spectrum of roundtable participants, was a proposal to establish an examiners academy here in the United States to train State, local, and Federal examiners on Bank Secrecy Act issues, and also train foreign examiners to ensure that baseline standards, mission, and evaluation are uniform. My idea was inspired in part by the stories from banks in the U.S. about the dramatic differences in the reviews of banks and services typical to rural America versus the types of activities that one sees in Miami or other centers of international finance.

You were there. What is your perspective on this proposal, both as a leading correspondent banker in the region and as a representative of the financial and international bank business association whose members are banks of all sizes and types doing business overseas?

Mr. SHAH. Thank you very much for the question, Chairwoman Waters. I support 100 percent the idea of a training academy. In fact, one of FIBA's cornerstones is a training academy where they train regulators and bankers and provide a lot of feedback for the industry.

There are two main issues when it comes to looking at a training academy. We know that our examiners are very well versed with the Federal Financial Institutions Examination Council (FFIEC) manual, and they understand the BSA/AML regulations. The problem is that it is not a one-size-fits-all approach. So, a regulator that just spent a lot of time in the Midwest working with retail banks comes into Miami and almost has a heart attack when he sees international transactions from Colombia and Brazil, and the Caribbean. It is not an opportunity where he is very familiar with those transactions. Sometimes what you find is that when you look at his approach, our members have told us that he starts with his enhanced due diligence hat, and everything is high risk. That makes the examination a little different from how it would have been if he were with a small regional bank.

The second part is, when you look at assessing a bank's risk and you are training for it, that the risk-based approach that we have been taught to apply is usually very subjective, so we would need two things to happen: first, we would need guidance that talks about exactly what we are being examined against; and second, when we have a business that is correspondent banking, for example, automatically, everybody thinks that is high risk. It is high risk for a bank that does not have a program in place to manage those risks, but it is just business where a bank that spends a lot of time putting in programs and technology to be able to manage the risk and do the business successfully.

I do agree with you that we need some sort of training academy. I think it would help the industry. I think it would be something that would level the playing field so that examiners are all reading from the same book, but I do believe that we would need proper guidance as to how the rules and regulations are applied. And every bank is specific, and every bank has a different risk profile, so—

Chairwoman WATERS. Thank you.

Mr. SHAH. Thank you.

Chairwoman WATERS. Thank you very much. The gentleman from Arkansas, Mr. Hill, is now recognized for 5 minutes.

Mr. HILL. Thank you, Madam Chairwoman, and thanks for holding this hearing. Many of us have lamented President Obama's, and President Trump's, and President Biden's lack of emphasis on the Western Hemisphere, the Caribbean, Central America, and all of Latin America, so I commend you for engaging with our great friends in the Caribbean. It's so critical to our economy and their economy. We are inextricably linked. Thank you for holding this hearing, and I am intrigued by what I have heard today. I think the presentations have been excellent. I am delighted to have had her excellency, Prime Minister Mottley, with us as well. She is a great global leader on financial matters.

The Caribbean has its share of challenges. If you Google fraud and schemes in the Caribbean, a long list by country comes up of real challenges out there for the citizens and individual Caribbean countries. And, of course, we have had testimony in this panel for many, many years over our own citizens here in the United States who were victims of, "Sir Allen Stanford's" crimes in Antigua, which certainly didn't help the reputation of the region.

My question first to Mr. Shaw is, do you believe that the financial action task forces and the financial intelligence bureaus of our Caribbean nations are up to par? Are they doing good work, because that is where some of this starts?

Mr. SHAH. Yes, I do believe that those organizations do good work, and they have been very helpful in raising the bar. A lot of the issues that you see in the Caribbean are not specific to the Caribbean. They happen all over the world, and the impact from those issues are looked at differently. So, the same financial crime occurring in Europe or the United States, when it happens in the Caribbean, it is magnified. In the case of Mr. Stanford, he was actually from Texas.

Mr. HILL. Yes. We don't need to delve into that. Just, do you think they are doing a good job?

Mr. SHAH. I think they are doing a great job.

Mr. HILL. Thank you for saying that. You have an eyewitness to that.

Ms. Delmar, do you agree that the governments in the Caribbean are doing a good job in their financial action task forces and their financial intelligence bureaus?

Ms. DELMAR. Absolutely. And I wanted to lean on what was said a little bit earlier in that bad actors exist everywhere. And I think that given the limited resources that we have in the Caribbean, and again, based on the scale of these islands, any one infraction against the law is seen as a significant infraction. However, I believe that everyone involved is having a similar dialogue, and in terms of ensuring that from a legislative and regulatory perspective, we are keeping up to standard. And from a banking perspective, we are also ensuring that we show up what is required from a KYC and monitoring process as well.

Mr. HILL. Thank you for that.

Ms. Shetret, you talked a lot about, and this applies to Mr. Shaw's testimony, too, that fintech, of course, can help lower compliance costs. One of the largest banks in Florida is in my constituency in Arkansas, and I know what their AML/BSA compliance burden is monthly trying to comply with FinCEN, but they use fintech to lower that cost. Isn't that a way to really help our Caribbean nations be a more banked place and make it easier for correspondent banking if we used technology to sort through the AML/BSA compliance?

Ms. SHETRET. Thank you. Absolutely. Fintechs do lower compliance costs in a way, and the way they do that is by removing the noise. So reducing false positives, compliance teams can be focused on high-risk areas. They can utilize their resources more smartly in a place with lower capacities or lower resources. You get to focus on your work and your teams.

Mr. HILL. Yes. Thank you. That is helpful. I think that helps our citizens in the Caribbean nations and it helps our correspondent banks as well. And this de-risking thing comes from a lot of regulation put on by this Congress that raises the cost that makes it more difficult to comply, so I think fintech is part of that solution.

But, Mr. Shah, if the U.S. financial institutions are exiting from correspondent banking, who is stepping into the Caribbean market? Who are you seeing stepping into the correspondent banks there?

Mr. SHAH. We have seen a couple of payment processors stepping in.

Mr. HILL. Who is that?

Mr. SHAH. There is—

Mr. HILL. You can submit it for the record. Any other commercial banks that have stepped in from Europe or elsewhere?

Mr. SHAH. There are a couple of banks, well, banking-type organizations, financial organizations from Europe.

Mr. HILL. If you would submit those for the record, that would be very, very helpful to outline who is coming into that market, if U.S. financial institutions are stepping out due to the regulatory burden. Thank you, Madam Chairwoman. I yield back.

Chairwoman WATERS. You are welcome. Thank you, Mr. Hill. The gentlewoman from New York, Ms. Velazquez, who is also the Chair of the House Committee on Small Business, is now recognized for 5 minutes.

Ms. VELAZQUEZ. Thank you, Madam Chairwoman. This is an important hearing, and I really appreciate you doing this.

Mr. Shah, Puerto Rico possesses a high number of CBRs given its integration with the U.S. banking system. As the only member of this panel representing a major U.S. financial institution, could you please provide us with an overview of these connections, and what are your suggestions for deepening their impact?

Mr. SHAH. Pardon me. I didn't hear the beginning of your question as people were leaving the room. Could you repeat that for me?

Ms. VELAZQUEZ. Puerto Rico possesses a high number of constituent bank relationships (CBRs) given its integration with the U.S. banking system. As the only member of this panel representing a major U.S. financial institution, could you please provide us with an overview of these connections, and what are your suggestions for deepening their impact?

Mr. SHAH. Currently, we support Puerto Rico with correspondent banking, and one of the largest banks there is a customer of ours with over 40 or 50 percent market share. So, we are supporting that region. It is not in my purview, it is not part of the English-speaking Caribbean, but I will be more than happy to have someone respond to you with some of the details.

Ms. VELAZQUEZ. Thank you. What options do we have for breaking the stigma about the concentration of illegal activities in Puerto Rico and other Caribbean nations, like we have been this past year, that triggers financial institutions decision to de-risk?

Mr. SHAH. I think financial institutions make their decision to de-risk based on their risk appetite and the profiles of banks that they want as customers. Individual banks need to make that determination themselves. The stigma, I think, should be driven by what we see in terms of prosecution of financial crime and actual cases of financial crime. And in the Caribbean, there are very, very few areas and instances where we see high-level financial crime being prosecuted, or the instance of validated cases of financial crime. That is part of the problem where the perception does not meet the reality.

Ms. VELAZQUEZ. Thank you. Ms. Delmar, does the rise of cryptocurrency in the region pose a threat to your harmonization efforts?

Ms. DELMAR. Thank you for the question. At this stage, we have not seen a significant influence in the region, which suggests that this is not an ongoing issue or something that we need to be absolutely concerned about. However, we also recognize, as was previously discussed on some of these panels, that people will find unique and creative ways of ensuring that they are able to get through the banking system in ways other other than banking. And so, again, from the banking community, we have been keeping a very clear focus on activities around crypto within the region, but to date, we have not seen anything that is suggestive of a significant concern.

Ms. VELAZQUEZ. Thank you.

Mr. Mowla, how does the steadily-reduced access to financial services in the Caribbean due to banks' de-risking efforts affect the prosperity and security of not only the Caribbean region, but the United States as well?

Mr. MOWLA. Sorry. Could you please repeat the first part of the question?

Ms. VELAZQUEZ. How does the steadily-reduced access to financial services in the Caribbean due to banks' de-risking efforts affect the prosperity and security of not only the Caribbean region, but also the United States as well?

Mr. MOWLA. Thank you for the question. Mostly, correspondent banking is vital for cross-border payments. So if people want to send remittances back to the Caribbean, want to invest in certain sectors in the region, they are likely unable to do so if correspondent banking is not available. When we talk about nearshoring, when we talk about new U.S. economic policy, growing investment in our own hemisphere, we need to have access to the correspondent banking in order to have that sort of influence.

Ms. VELAZQUEZ. Thank you. Madam Chairwoman, I yield back.

Chairwoman WATERS. Thank you very much. The ranking member of the committee, the gentleman from North Carolina, Mr. McHenry, is now recognized for 5 minutes.

Mr. McHENRY. Thank you, and thank you, Madam Chairwoman, for hosting this hearing today or organizing the hearing today. We have heard a lot about risk management, compliance, and profitability, and I appreciate the witnesses on this panel.

Ms. Shetret, is it fair to say that when a customer is unbanked or de-risked, they do not simply disappear or go away?

Ms. SHETRET. Yes. That is correct.

Mr. McHENRY. Okay. So, the customer still needs to be banked regardless of the risk, correct?

Ms. SHETRET. Yes, also correct.

Mr. McHENRY. Okay. Is it accurate to say that when one bank terminates a customer's account through, "de-risking," it is not really de-risking at all, but it is re-risking?

Ms. SHETRET. Absolutely, that is correct. I would agree with that statement. The reason I agree with that is because the risk doesn't disappear into the ether. It is simply moved or shifted into another space. That other space might be a smaller bank, a smaller institution that can't cope with the size of risk that is being shifted on to it. It doesn't have the anti-money laundering controls in place. It doesn't have the framework to deal with it. It might also shift into other more unsavory jurisdictions that are not observing any kinds or maybe minimal or lacks regulatory structures in place, and that is the concept of regulatory arbitrage. And then, it might shift altogether underground, which is something we need to avoid.

Mr. McHENRY. Okay. And are we talking about illicit businesses here on the main, or are we talking about legal businesses?

Ms. SHETRET. Both legal and illegal businesses.

Mr. McHENRY. Is there a mechanism to get to illegal businesses? We are not going to ask the bankers to do this, right? We are going to ask the accountants, the FBI to do it, right? It seems like this is shifting the responsibility of a government obligation onto the private sector in some ways.

Ms. SHETRET. The private sector does need to step up and become police of sorts to make sure that they are keeping bad actors out of their platforms and systems.

Mr. McHENRY. Okay. Let's shift to the legal businesses, maybe disfavored businesses, maybe people, businesses catering more to those who are living on the wrong side of the tracks, maybe mostly engaging in cash, because that is how they have to manage their credit risk because they don't have credit, right? So, you are taking those perhaps small businesses—they are illegal—that are disfavored, and you are taking them into less-sophisticated institutions, and saying we have done a good job, right?

Ms. SHETRET. Yes.

Mr. McHENRY. It doesn't seem like that should be sound public policy, or it shouldn't be a sound policy outcome.

Ms. SHETRET. I will bring it back to the risk-based approach that both international standards and jurisdictions ask of financial institutions to account by, which is that you need to, as a financial institution, assess the risk of the customer in front of you, medium, small, whatever, whomever is standing in front of you—legal, illicit—understand the source of the funds, and then based on that, mitigate those risks. Smaller institutions or institutions that do not observe AML/CFT frameworks are not equipped to handle those kinds of businesses, and they get shut out of the system as they sort of jump between banks trying to access financial services.

Mr. MCHENRY. Okay. And is this driven by AML/BSA requirements? You are seeing de-risking?

Ms. SHETRET. Partially driven by that, and also a profitability calculation where in some instances, it just doesn't reward financially to bank high-risk customers, for example, nonprofit organizations that are moving funds for humanitarian needs to different parts of the globe that require more due diligence.

Mr. MCHENRY. Okay. But the due diligence piece—that means you have to have more people, more employees reviewing these account-level transactions?

Ms. SHETRET. Not necessarily. This is where we would say that fintech solutions come into play, and we need to innovate around to—

Mr. MCHENRY. They come into play, but that is not the driver here.

Ms. SHETRET. Right, not the driver.

Mr. MCHENRY. Right. We just passed our AML/BSA reform package last Congress, with a major rewrite of FinCEN, the beneficial ownership regime here. The goal here, or at least the goal when we started the conversation when Republicans were in charge was to drive the expense structure away from people into technology. And this could be a less-burdensome thing so that these types of accounts could actually still be banked.

Ms. SHETRET. Yes, 100 percent.

Mr. MCHENRY. And that apparently is not the case.

Ms. SHETRET. That is not what is happening right now.

Mr. MCHENRY. Okay. Anybody think it is happening?

[No response.]

Mr. MCHENRY. No? Okay. We have our public policy work cut out for us still, Madam Chairwoman, and while we have made strides, we have more strides to make. Thank you all for your testimony and for being here. Thank you for raising this important international and domestic challenge here. Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you, Mr. McHenry. The gentleman from California, Mr. Sherman, who is also the Chair of our Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, is now recognized for 5 minutes.

Mr. SHERMAN. Thank you. I believe I am the only former tax collector in Congress. Why I would then be able to get elected is something to be studied elsewhere. But I do think that it is critical that we look at our anti-money laundering and our tax enforcement laws, and accomplish those purposes that could involve trillions of dollars to the U.S. economy, and then take a look at making sure that we are good neighbors and friends to those in the Caribbean, and help our Caribbean neighbors engage in every kind of economic development, except financial obfuscation and the tax shelter business. And I realized that, especially for the Cayman Islands, those businesses are very profitable, and they may not want to give them up. We should be willing to provide technical assistance to help our Caribbean friends deal with money laundering, et cetera, et cetera.

I will ask our witnesses, are there countries in the Caribbean that want that kind of help, and others, perhaps the Cayman Islands and others that specifically don't want that kind of help? Ms. Delmar?

Ms. DELMAR. Thank you, Congressman Sherman. It certainly is always in the best interests of our people when we can receive support that will consider all of the challenges that we are facing and all of the opportunities and solutions in addressing challenges of this nature. Certainly, from a legislative perspective, I believe that there is adequate monitoring, as mentioned previously, and laws to ensure that even those companies, for example, those banks are being monitored, so that their transactions fall within the required compliance regimes. However, as you have indicated, from a technical support perspective, I have no doubt in my mind that we would welcome the opportunity.

Mr. SHERMAN. Thank you. Without objection, I would like to put in the record an article from the Global Financial Integrity organization, dealing with financial crime in Latin America and the Caribbean and understanding each country's challenges.

Chairwoman WATERS. Without objection, it is so ordered.

Mr. SHERMAN. So, we ought to be providing technical assistance. I'll shift to a different question. Many banks are ending their correspondent relationship, not because of anything that a government has done, but because of what a government might do. They are concerned that Caribbean countries will apply bank secrecy laws or come up with other legal requirements that then conflict with American Know Your Customer laws.

Would it be helpful, Mr. Mowla, if Caribbean countries were to pass laws explicitly stating that complying with U.S. Know Your Customer laws is fully legal under their legal system, eliminate the risk that banks would be whipsawed?

Mr. MOWLA. Thank you for the question. I think what is really important here is dialogue, perhaps more dialogue between the U.S. and Caribbean counterparts.

Mr. SHERMAN. Do you think there are Caribbean countries willing to pass a law saying, go ahead, do business here, and you can also comply with American law, we are not going to tell you that you can't comply with American law?

Mr. MOWLA. I believe so. Caribbean countries and leaders are pragmatic actors. All that they are looking out for is the quality of life of their citizens, and if that is something that it would take, I think they would be open to doing so. I can't speak for any Caribbean leader and what exactly he or she may do, but it is something I think would be up for discussion, which is why I think dialogue is the way to go.

Mr. SHERMAN. I would point out that Antigua, the Cayman Islands, the Bahamas, Bermuda, the British Virgin Islands, and Turks and Caicos currently have zero corporate tax that makes them a tax shelter. The G7 has recently put together a program that we are almost in compliance with ourselves applying a 15-percent minimum corporate tax. And it would certainly be helpful if our Caribbean friends were to join that scheme until all the corporations in the world, at least all the multinational corporations in the world, need to pay a 15-percent tax. I look forward to working on these issues, and I yield back.

Chairwoman WATERS. Thank you very much. The gentleman from Florida, Mr. Posey, is now recognized for 5 minutes.

Mr. POSEY. Thank you very much, Madam Chairwoman. Ms. Shetret, what does research say about the effectiveness of anti-money laundering laws in combating underlying crimes, such as drug trafficking and terrorism?

Ms. SHETRET. We are fairly effective in having the criminal framework in place. What now matters is the implementation and to ensure that the implementation occurs across jurisdictions in a standardized manner. So, what we are seeing is that while some countries are stepping up to implement those and adapting those broad principles into their local legislation frameworks, the challenge becomes across countries and communicating, prosecuting, investigating cases when they don't interact, or when they don't have the same standards in place, or perhaps more lax standards.

Mr. POSEY. Thank you. Anti-money laundering regulations have shifted substantial law enforcement costs burden to financial institutions. How can the Federal Government contribute to reducing those costs?

Ms. SHETRET. I'm sorry. Could you repeat the question, please?

Mr. POSEY. Sure. Anti-money laundering regulations shift substantial law enforcement costs to financial institutions. How can the Federal Government contribute to reducing those costs?

Ms. SHETRET. Yes. One of the things that needs to happen is an additional kind of practical clarity and guidance around, what do these concepts mean in practice? We have seen now that we are almost in a hybrid economy that is both digitized and both cash-intensive in many countries, and so redefining a lot of the same bread and butter concepts from compliance just into the new practical behaviors in which we operate with updating these principles. And clarifying, basically removing ambiguity is what needs to happen.

Mr. POSEY. Okay. Thanks. What role might the Federal Government play in improving the quality of data available to financial institutions to form their anti-money laundering regulation responses?

Ms. SHETRET. When it comes to data at the moment, it is spread across different agencies. And one thing that could be useful is sharing back with industry and with banks, financial institutions, a holistic view of, for example, insights from suspicious activity reports. What is it that are sort of macro trends that are being observed around criminality or typologies, or regions, or specific areas as the susceptibility, so that industry can respond? At the moment, there is a lot of communication coming towards government, and a lot of work is being done to process those amounts of data, but having more dialogue around actionable insights could be more timely in helping banks respond.

Mr. POSEY. Do you personally think the reforms instituted by Congress and the Executive Branch in the wake of Operation Choke Point have effectively addressed the abuses of that program?

Ms. SHETRET. I'm sorry, sir. Could you please repeat the question?

Mr. POSEY. Sure. Do you believe the reforms that were instituted by Congress and the Executive Branch in the wake of Operation Choke Point effectively addressed the abuses of that program?

Ms. SHETRET. Yes. Operation Choke Point from 2013 really gave the Department of Justice actionable work in which it subpoenaed over 50 different agencies across industries to bring forward activities from organizations that were really not both legal and illegal, stigmatizing them and offering them a reputational risk, which, since then, banks have really not been able to shake off. There is an opportunity to understand that definitions of risk—high, medium, and low risk—must be tailored and unpacked specifically to industry and actors to avoid kind of sweeping, and thus, sectoral or industrial stigmatization, which is a little bit of a leftover ripple impact from Operation Choke Point.

Mr. POSEY. Okay. Thank you. What types of changes do you think Congress should make to improve the efficiency and fairness of our anti-money laundering laws?

Ms. SHETRET. The United States has a big role to play and plays it quite actively in a variety of international fora. The Financial Action Task Force has been mentioned, the Wolfsberg Group. There is a real opportunity when it comes to the Caribbean and other regions to utilize regional organizations to help use American clout in those forums, to push for additional detail and ambiguity, dispelling a lot of those regulations that are being put out. Additionally, there is an opportunity to push on innovation and bring innovative actors to the table and make sure that we have an opportunity to share solutions for some public policy issues that are continuing to trouble Congress and otherwise.

Mr. POSEY. Thank you. My time has expired, and I yield back. Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much. The gentleman from New York, Mr. Meeks, who is also the Chair of the House Committee on Foreign Affairs, is now recognized for 5 minutes.

Mr. MEEKS. Thank you, Madam Chairwoman. And I thank all of our panelists. Let me start out with Mr. Mowla. I represent one of the most diverse districts in the country, and a significant number of my constituents are immigrants who use banking services to remit money back home to their family members, and loved ones, and their home country. But the ability to send and receive these funds is dependent on the ability to use the banking services and access them at reasonable costs.

You noted in your testimony that fee hikes and correspondent banking services, for example, and the use of wire transfers are an obvious negative impact on the customer, but it also seems to have a trickle effect. And the more that these individuals turn away from using banking services, the harder it will be for correspondent banking, which is typically fee-based, to cover the cost of compliance.

My question is, we always focus on underbanked communities here in the United States, but we also must assess the policy that exacerbates circumstances for underbanked communities abroad. Can you please explain what the impact of de-risking is on our diaspora and immigrant communities here in the United States, like many of the people that reside in my Congressional District?

Mr. MOWLA. Thank you for the question. I have been living in Queens for quite some time. I definitely would love to answer this. First, in the Caribbean, remittances basically supplement working-class income. We saw this in Jamaica during the pandemic, where remittances actually went up because it was seen, like Prime Minister Mottley said, that we are all family. We needed to help Jamaica when the tourism industry closed down because of the pandemic. Now, it has the same effect in immigrant communities, especially the Caribbean diaspora population as well, because they are disproportionately affected, especially as people of color. And if they cannot pay the fees in order to send remittances home, then they have family members who are unable to sort of have their own incomes, but also travel back to the United States.

As you well know, many in the Caribbean diaspora don't just come for a week, or a weekend or two. They come for weeks. They come to shop, they eat at restaurants, they stay in hotels, and it actually becomes a vibrant part of the U.S. economy. Thinking about Queens, you are thinking about a tristate area. Texas, California as well, so it all has a circular effect. So, being able to help sort of the Caribbean populations who receive these remittances has an effect that allows them also to purchase goods from the United States. The Caribbean is reliant on importing goods for most of their local businesses, and the tourism industry. Bed sheets, pillowcases, all of that is really bought in the United States. Now, how are they able to buy it? They are only able to buy to it if they can receive remittances from the diaspora in the United States.

Mr. MEEKS. Thank you for that. And let me go to Ms. Delmar quickly. Caribbean countries require access to the international capital markets, and most of their economies run large and persistent physical trade deficits with the rest of the world and they heavily rely on imports for food, fuel, and capital goods not produced domestically. So, I was heartened to see that, for example, Barbados led the Colombian Trade and Investment Forum earlier this month. This exploration and potential collaboration, I think, could be just the type of innovation needed to foster prosperity in CARICOM countries and on the continent of Africa. In what ways do you think we in the United States can support unique solutions to the challenges of growth and prosperity by drawing on the talent and potential of diaspora communities?

Ms. DELMAR. Thank you for that question. You are correct in that. The Caribbean remains very receptive to opportunities for innovation and creativity in terms of ensuring that we maintain vibrant economies. And like you rightly mentioned and pointed out, Barbados' initiative in ensuring relationships are being established with the African Export-Import Bank (Afreximbank) in Africa is one of those areas that we see as a potential opportunity for us to continue to maintain that vibrancy that we need to maintain healthy markets.

Similarly, with the U.S., we are hoping that the relationships that we have lost through correspondent banking will be returned based on the discussions that are happening now, but also the opportunities to continue to trade in more meaningful ways. For example, we want to ensure that U.S. citizens will see the Caribbean, and certainly through the diaspora will see the Caribbean as a place to invest, and invest safely, because the Caribbean maintains the same levels of monitoring that the U.S. requires that we do. And so, we should be seen as a safe zone as opposed to the perception of a high-risk jurisdiction. The Caribbean sees itself as a third border to the U.S., and through that alone, it says that we are here to do business. We want to ensure the safety of the financial services sector, and the Caribbean Association of Banks and our members always ensure that we conform to the requirements of regulation to ensure that the markets remain safe.

Mr. MEEKS. Thank you very much. I yield back.

Chairwoman WATERS. The gentleman from Missouri, Mr. Luetkemeyer, is now recognized for 5 minutes.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman. Ms. Shetret, I think you mentioned a minute ago the words, "reputational risk," and I looked up the definition of this. According to a supervisory regulation letter from the Federal Reserve, "Reputational risk is the potential that negative publicity regarding an institution's business practices, whether they are true or not, will cause a decline in the customer base, cost of litigation, or revenue reductions." Whether it is true or not, and that's according to the Federal Reserve, so when examiners go in and they intimidate the banker, the loan officers, the executive board, the board itself by saying there is a reputational risk to what you are doing, not even knowing whether it is true or not, it is their interpretation, it is their idea, it is their belief that it could be happening rather than factually saying it is happening, is to me a very poor way of going about regulation. Do you think it is appropriate to monitor banking services based on risks that are not based in fact?

Ms. SHETRET. I agree that it is important to make sure that we are based in facts and in factual assessments, particularly utilizing on-the-ground information that examiners are obtaining. Attempting to leave all biases at the doorstep is very important. The relationship building between an examiner and a financial institution should be an open one, one that allows for influencing each other with information.

Mr. LUETKEMEYER. You made a comment ago about Operation Choke Point. Do you understand what I am talking about here? Operation Choke Point was when they were doing this intentionally, knowing that they were trying to drive a business out of business that was not doing something illegal. They were trying to intimidate the banks into getting rid of financial services or squeezing an industry or an individual whenever you don't even know if it is true. This is the horrible part about Operation Choke Point is that they were going in with their own personal biases versus fact, and that can't happen.

I just spent the last several months working with the FDIC Comptroller, the CFPB Comptroller, the FDIC, the Federal Reserve, and FinCEN, as well as credit union folks, trying to take out the independent ATM operators based on the fact they believe there is money laundering going on, which they finally admitted was not going on. They were intimidating the banks into cutting off financial services based on something that wasn't true. What is the recourse that these industries, these individuals have when they get squeezed out of being able to have accounts in banks?

Ms. SHETRET. The good news is Operation Choke Point is over, and I would caution—

Mr. LUETKEMEYER. Oh, it is not. It is going full speed. As I just said, I just got done working on this issue and just got a letter back on it about 6 weeks ago to stop the nonsense. It is still going on today. It is still going on from the standpoint of the far left. It is trying to intimidate banks and cutting off services to energy companies. That goes on in this committee right here. So, it is still going on today. I am going to apologize to you for interrupting here, but don't misunderstand. This is still there. It has just taken a different form. You may proceed.

Ms. SHETRET. Financial institutions were required to operate logistically. They are going to go where they can operate openly, freely, and conduct their business. If we are closing that opportunity for them, they will just go elsewhere, and they will go to the places where they can operate without the fear of examiners coming in. Practically, what I would say is that examination books and guidance needs to be updated. It needs to be updated from a variety of different perspectives, including around personal conduct, around what is actually tested, how it is tested, the kind of evidence that financial institutions need to submit. And there needs to be cautioning around bias and the reputational challenge and adverse media associated with it.

Mr. LUETKEMEYER. I have a bill, and it has actually passed the House, that stops the nonsense. It forces banks to disclose to the customer when you close an account why you did it so that the customer actually knows what the problem is, so they can then hopefully remedy that situation, or the next place they go, they can show that we fixed the problem, or down the road it can be remedied, and so that there is not this bias that is going on, this reputational risk threat that is going on, so we can stop the nonsense. So, it is important to me, and I think that we understand that the regulators are the ones who are imparting this reputational risk nonsense out there.

The other ones they are promoting is sort of interpretation and this intimidation. Now, the banks have to push back on this and say, show me where I am wrong. Prove to me that there is a problem here. I don't support banks that have problems, but I do support the proposition that we have to make the examiners do their job, which is to only examine with regards to whether the laws are being complied with, not to make stuff up, which reputational risk, according to definition by the Fed itself, says could not be true.

Ms. SHETRET. I agree to that. Thank you.

Mr. LUETKEMEYER. Thank you very much. I yield back.

Chairwoman WATERS. Thank you very much, Mr. Luetkemeyer. You and I may have something we can work on together.

Mr. LUETKEMEYER. [Inaudible].

Chairwoman WATERS. Thank you.

Mr. LUETKEMEYER. Let me write this down.

Chairwoman WATERS. The gentleman from Colorado, Mr. Perlmutter, who is also the Chair of our Subcommittee on Consumer

Protection and Financial Institutions, is now recognized for 5 minutes.

Mr. PERLMUTTER. Thank you, and I have a question first, but then I want to respond to something Mr. Luetkemeyer had to say, so I hope he stays in the room for a few minutes. I want to thank the panel for being here in Washington on one of our busiest days where we each have, like, five committee meetings going at the same time. I just want to apologize in advance. Other people are running around. I had a chance to meet many of you when I visited the Caribbean with the chairwoman and participated in the roundtable that the Prime Minister established and the chairwoman put together. Mr. Shah, I am going to start with you, sir.

Chairwoman WATERS. Excuse me. One moment before you do that. Mr. Luetkemeyer is anxious to get out, and you wanted to engage him?

Mr. PERLMUTTER. But I have to do the first question to lead to the second question and the response. Okay. I will start with Mr. Luetkemeyer, to let him get out of here. There are sort of three things that are potential risks—crypto, drugs, and tax shelters—that we saw. And one of the things that came up a lot was safe banking actually, Mr. Luetkemeyer, where we have your bill on dealing with Operation Choke Point to stop that reputational risk component. And to Mr. Luetkemeyer's credit, his bill is in the Safe Banking Act, which provides a safe harbor for banks that provide banking services to the marijuana industry. His bill has passed the House 7 times now, and we are going to get it passed in the Senate, I think, in the next few months. So, we are going to be able to deal with that reputational risk concern that you have because much of what they are facing in the Caribbean, it was clear that there had been some redlining going on, in my opinion, of the entire region, which is a doorstep to America, and they are our friends and we ought to treat them like friends.

And we aren't in the banking industry, with the exception of Wells Fargo, quite frankly. A lot of people had withdrawn because of these reputational concerns, some of it dealing with cannabis. And we can at least address that if we get that done, that bill passed that has a lot of your language in it. That was the only thing I wanted to say to the gentleman.

Mr. LUETKEMEYER. I thank the gentleman, and we are working together on that bill diligently, and your efforts are to be commended. But yes, I think where there are problems, we need to be concerned about it, whether it is illegal drug dealing, money laundering, or whatever the illicit problem is. But I think reputational risk is something that should be off the table because the way that is defined, the way they use it as an intimidation tactic is something that can't be tolerated. But I support your efforts and anybody else's efforts here to make sure we have some clean entities to go to and handle money and transactions in an effective and efficient way.

Mr. PERLMUTTER. And I thank the gentleman for sticking around for a second.

Mr. Shah, welcome. I didn't forget about you. We saw Wells Fargo was one of the few American banks left doing correspondent business in the Caribbean. In your testimony, you described how despite the risks, your bank chose to stay in the region and work to mitigate those risks. Specifically, you described how Wells Fargo worked with other banks, other Caribbean banks to help them improve their anti-money laundering and Bank Secrecy Act programs. Can you please expand on what types of information and tools you provided to help these other institutions improve their risk management?

Mr. SHAH. Thank you for the question, and it is nice seeing you again. As part of our business, one of the things we do is conduct independent analysis and risk analysis for the counterparties and the countries in which we do business, so we take a hands-on approach to working with our respondent banks. In the effort to elevate them, we have done three major things. One is engage them to understand their programs and how that fits into the business type that they are doing. The second thing we talked about is how well they comply with the necessary rules and regulations that make them safe. And one of the safeguards that we take pride in is making sure that we accept transactions that are safe and sound, and we prohibit transactions that are in the shadows so that we protect the U.S. financial system. That is our main priority.

We spent a lot of time with remediation, working with them to explain to them our risk management policies and procedures. We have an annual get-together for all of our customers where we talk about the new rules and regulations, our way of looking at them, how we manage risk, alignment of risk appetite, and what they should expect in terms of challenges. We also work with the industry through FIBA to make sure that they have available training, to make sure that they have a forum for discussion and to air their concerns, and to react with them, and work with them to make sure we clear that up. So, we provide a great deal of support not only in banking them, but also helping them navigate with the changes.

Mr. PERLMUTTER. Thank you, sir. My time has expired. I yield back to the Chair.

Chairwoman WATERS. Thank you very much. The gentleman from Texas, Mr. Williams, is now recognized for 5 minutes.

Mr. WILLIAMS OF TEXAS. Thank you, Madam Chairwoman, and when we are talking about money laundering risks, we cannot ignore the absolute disaster at the Southern border. Over 2 million people have been apprehended this fiscal year alone, and this number doesn't include those who successfully evaded Border Patrol agents. Even The New York Times admitted this summer that drug smuggling revenues are estimated to be up $13 billion this year, up from only $500 million in 2018.

And open borders—I live in Texas, full disclosure, so I have been down there a lot—are not only enriching multinational criminal organizations, but the consequences are also having a very real impact in our communities. The Texas Department of Public Safety alone has seized more than 340 million lethal doses of fentanyl this year, and we all know what a small dose of fentanyl can do to people. Additionally, a record number of migrants have died along the Southern border this year: 750. The Biden Administration must start thinking about this seriously, and they are not doing it.

Ms. Shetret, from the financial services perspective, what are some ways we could better track the proceeds from illicit activities flowing to drug and human trafficking organizations?

Ms. SHETRET. At the moment, financial institutions are able to follow the basic policies and procedures in place that are very manual and very labor-intensive. They are basically looking for a needle in the haystack to try and identify those particular proceeds within the banking system, and that is cumbersome. If we start thinking about how we could implement some innovative transaction monitoring, perhaps those that are blockchain-based, what we might find is that there is a concept of traceability that goes and provides visibility end to end. Where has money been? Where is money going?

And so, when we think about innovating around the U.S. digital dollar, whatever that might look like, and the thoroughness of work that needs to go into developing that, something that is blockchain-based will allow us to better identify and track, stop, cease, confiscate, and hold illicit proceeds so that we are able to prescreen rather than post-investigate those kinds of instances.

Mr. WILLIAMS OF TEXAS. Yes, a lot of things have been happening after the fact. One way to make it easier would be to secure the border and have fewer people in the business, right? But if you go down there, it is just unbelievable what you are seeing, the drug traffickers in there and so forth with these young kids. But if we would get after it and really secure the border, we would slow a lot of this down.

As we talk about de-risking, I feel like I need to share my experience when I was targeted under Operation Choke Point. I am probably the only person in this room who has been affected by Operation Choke Point. I received a call several years ago from my bank, and I was told that I had 24 hours to move my money out of there because they no longer wanted to do business with me. I am a car dealer, and they didn't want to do business with me. This is a bank I was on the board of for 24 years, with no problems, and they decided in 24 hours that they didn't want my business because they no longer wanted to do business with me. And I have been with this bank, as I said, for a long, long time. To this day, they have never told me why.

I can't imagine what pressure the bank had to sit down in a community where everybody knows everybody, would have had to sit down and say, okay, who is going to call Roger and tell him that? I can't imagine the pressure they had to stop doing business with me. It must have been unbelievable. And this just shows if this can happen to a sitting Member of Congress, on a board of directors, or somebody who has been in the community forever, it can happen to anyone, and it is a total crisis. And I was lucky that I had a bank that would take my business, which was a decent business, 89 years we have been in business, but some people don't have that luxury. I know you have looked at Operation Choke Point and its effects on the marketplace. You talked a little bit about it just a minute ago.

Can you talk about the negative consequences of indiscriminately de-risking entire industries? There were at least 40 industries on a piece of paper somebody wrote down, so we don't do business with them. We don't want to do business with them. And these are family-owned businesses. This is capital that people have put in, their own money, and to just be wiped off the board is not the way that we are supposed to do things here in America. Quickly, can you talk about some of the consequences that you have seen in wiping out industries?

Ms. SHETRET. I am sorry to hear of your personal experience there. Thank you for sharing that. I think that the disappearance of brick-and-mortar banks, the disappearance of kind of that personal interaction is one consequence that we are seeing, which emphasizes the need for digital Know Your Customer (KYC) so that we understand who you are when you come to bank. The loss of sectors means that we are having entire swatches of business that are going where they can find banks. If that is out of the United States, that is where they will go. They will go find the first opportunity to properly bank and conduct their business, which means that innovation is leaving, which means that there is a movement. The borders are becoming inconsequential if the provision of services is not maintained here. There is a loss of intellectual property, there is a loss of jobs, and we need to find a way to offer banking services. There is a financial inclusion risk where people who had access, ATM businesses and so on, are unable to maintain bank accounts. That is challenging across-the-board, and is actually inhibiting financial inclusion.

Mr. WILLIAMS OF TEXAS. Okay. I yield my time back, Madam Chairwoman.

Chairwoman WATERS. Thank you. The gentleman from California, Mr. Vargas, is now recognized for 5 minutes.

Mr. VARGAS. Thank you, Madam Chairwoman. I appreciate very much this hearing, and I learned quite a bit. In fact, most of my questions have been answered. However, one of the questions that I did have, my good friend, Mr. Hill from Arkansas, was pursuing. Of course, he always has very insightful questions and perspectives. He has great experience both in the private sector and in government, and he asked, what happens when American financial institutions leave? Who takes their place? And I think he asked all of you to get back to him on that.

But if you could maybe speak a little bit about that now, because my question was going to be, is it the Chinese banks that have established themselves? And I understand that China uses the U.S. disengagement as an opportunity to expand its Belt and Road Initiative (BRI) in the Caribbean and challenge U.S. diplomatic and economic regional influence. Recently, seven Caribbean countries—Antigua-Barbuda, Barbados, Dominica, Grenada, Guyana, Jamaica, and Trinidad and Tobago—have signed BRI agreements with China. As a result, Chinese investments in the Caribbean will total over $16 billion in infrastructure and financial partnerships over the next 25 years.

According to the Caribbean Development Bank, Caribbean countries have readily grasped Beijing's offer of easy financing as traditional U.S. financing partners have pulled out of the region. To all of the panelists, can you provide some information about this? Because it does concern me.

Mr. MOWLA. Thank you for the question. I think the United States has the upper hand in the situation relative to Chinese engagement in the Caribbean. China has a very one-dimensional relationship with the Caribbean, usually economic. You mentioned the Belt and Road Initiative. You mentioned investments, potentially Chinese correspondent banks and Chinese currency in the region. The U.S. has a more multidimensional relationship. We think about politics. We think about security. We think about diplomacy. These are all things that the U.S. does well. You just have to look at the U.S. Southern Command and the trade winds exercise in the Caribbean as a prime example, and now what the U.S. needs to compete is more on the economic side. Their economic linkages do exist there, but they exist in trade. They exist in investment appetite. Where it is severely lacking is in the correspondent banking, in de-risking.

And as I said before, many of the U.S. economic policies that have been recently announced specifically at the Summit of the Americas, PACC 2030 being announced by Vice President Harris, none of that will matter if correspondent banking is not available to Caribbean countries, to people their institutions.

Mr. VARGAS. Anybody else?

Mr. SHARMA. Thank you for the question. I will offer a couple of thoughts on this as well. Part of the challenge here is exacerbated by some of the thoughts conveyed earlier as related either to reputational risks and/or sanctions policy by the U.S. Government. If, for example, and I commend the great work, Madam Chairwoman, on looking at revisions on how, for example, the INCSR report works, because if banks look at an official U.S. Government document that effectively labels a region as high risk, U.S. institutions governed by U.S. regulators will leave that region, leaving holes for both investment, technological, technical assistance, and financial services opportunities.

You rightly point out that one major government, China, has very much increased its investments not only in the Caribbean, but across the world, Latin America, Africa, et cetera, where U.S. institutions, U.S. companies, have either been denied by way of sanctions policy or by various U.S. Government and other initiatives that have either labeled directly or indirectly those countries, those jurisdictions as being categorically higher risk.

And then, as my colleagues here explained, if an institution regulated by U.S. regulators is now doing the cost-benefit analysis of saying one is higher compliance risk, and, therefore, I am going to be scrutinized more and potentially subject to sanctions, low profits, or both, there is no incentive to do business there. I would say that part of the solution set is to create incentives by way of policy and legislative measures that actually incentivize positive foreign direct investment, including financial services access, into one of the most vibrant financial and capital markets on the planet, the United States.

And one of those ways, especially to the advent of financial technology applications, web-based digital asset applications, is one can now have the ability to put individuals households, corporations, and nonprofits in those regions into U.S.-based accounts, which would promote those regions, invest in those regions, and reestablish less of an enforcement-centric work of financial services and foreign policy in a much more incentivized development orientation that we really need to reorient our national and economic security policy.

Mr. VARGAS. Thank you, again. I found this hearing to be very positive, and I appreciate the chairwoman. Thank you.

Chairwoman WATERS. Thank you very much, Mr. Vargas. The gentleman from Ohio, Mr. Gonzalez, is now recognized for 5 minutes.

Mr. GONZALEZ OF OHIO. Thank you, Madam Chairwoman. Ms. Shetret, I am going to start with you and pick up on the China theme. We talked a little bit about this already. If you could, I would like you to sort of outline how does China's Belt and Road Initiative, from a financial standpoint and a sanctions avoidance standpoint, works in Africa? And then from that parallel, how do you see it potentially playing out in the Caribbean?

Ms. SHETRET. Thank you for the question. Since 2008, I have been working in the Horn of Africa, and I have seen the rise of the Chinese economic power. And I think I almost see it as the Back to the Future situation of the Caribbean, so I would like to describe it from that perspective.

The Chinese initiative at the moment is not time-bound. There is patience in the making, and we have seen that unfold over the years in Africa. What I have specifically noted is that around 2013, when many of the major banks de-risked businesses in the Horn of Africa and essentially left, what we saw was that China stepped up in a variety of different ways. For example, all Chinese-manufactured phones are hardwired with wallets that are directly connected to potential Chinese currencies and, essentially, bypassing settlement from the U.S. dollar.

Mr. GONZALEZ OF OHIO. Essentially pulling them away from the dollar-based system.

Ms. SHETRET. Exactly. And what that means when it comes to national security instruments such as sanctions and sanctions implementation is that enforcing sanctions becomes that much harder because the settlement is no longer against the U.S. dollar. We have no visibility into those transactions. We shoot ourselves in the foot in trying to follow the money and track that process.

Mr. GONZALEZ OF OHIO. So, the de-risking has led to this situation in Africa vis-a-vis China. Can you draw a parallel to maybe some fears we would have from a de-risking in the Caribbean standpoint? Do you think China would implement a similar policy potentially and set up with essentially bases around which to bypass the dollar-based system?

Ms. SHETRET. Yes. The parallel is certainly drawn, and it is certainly there. I would see a situation in which again, the patience, the build-out of mega projects that are infrastructure-based are accompanied by soft-tech solutions from China that are meant to establish economic power, and that is done across industries. In a situation in which there is full de-risking across the Caribbean, there are still businesses that need to operate tourism that needs to happen, activities, financial accessibility globally that will need to be ongoing. And whomever steps up to provide those services, Chinese actors included, will win that business, and that is the only option that would be left on the table.

Mr. GONZALEZ OF OHIO. Yes. The fear being what we have seen happen in the Horn of Africa, we will see again in the Caribbean, obviously.

Ms. SHETRET. Yes.

Mr. GONZALEZ OF OHIO. What, in your eyes, is the best response from a U.S. standpoint in terms of preventing that sort of thing from happening?

Ms. SHETRET. I would encourage us to expedite our exploration of the U.S. digital dollar, understanding what it could look like, assessing its opportunities and risks globally. There needs to be a U.S. dollar dominance assessment that encourages innovations.

Mr. GONZALEZ OF OHIO. I don't want to go too far on this. Dollar dominance is, frankly, a priority of mine, and I think of most members of this committee. I am not a CBDC digital dollar guy, but I know it is being negotiated, and I think if we are smart about articulating a stablecoin bill that mandates U.S. dollar-based reserves and makes sure that the stablecoins that are proliferating across the globe, the private stablecoins are dollar-backed essentially, I think that strengthens the dollar. I think that adds to our ability to implement sanctions and from both national security and innovation standpoints, puts the U.S. at the forefront of what I believe is one of the most exciting technological advances of my adult life. And I say that to encourage those negotiating on the bill to continue on, be thoughtful, and solicit feedback from those of us on the committee who spent a lot of time in this area. And with that, I yield back.

Chairwoman WATERS. Thank you so very much. And those who are negotiating, I hear you loud and clear. Thank you very much.

The gentlewoman from Ohio, Mrs. Beatty, who is also the Chair of our Subcommittee on Diversity and Inclusion, is now recognized for 5 minutes.

Mrs. BEATTY. First of all, let me thank Chairwoman Waters for holding this hearing today, and to all of our witnesses, thank you for being here today. I think we have all learned a lot. I am going to take about 20 seconds of my time for personal privilege, to thank the chairwoman for allowing me to join her at the chairwoman's CODEL to Barbados and to the Bahamas earlier this year. I had the honor of meeting with Prime Minister Mottley, who was on the panel before this one, and I want to make sure the record indicates that I thank her for her testimony and for participating in this hearing. Again, this chairwoman is making history.

When we talk about de-risking and its impact not just on the Caribbean, but the United States as well, certainly we have heard and we all know that it is a critical issue, and I am glad that we are calling attention to it. For all of those who are watching us, many of our brothers and sisters from the Caribbean, we hear you, and this is very real. I would like to begin by touching on some of the topics that we discussed, Chairwoman Waters, on your CODEL because many of the things we are hearing here today from our witnesses, we also heard in our roundtable.

Mr. Mowla, let me start with you. I know we have covered a lot today, and some of the things I am going to ask about, maybe several of you have touched on. But I want to talk about how we can provide technical assistance for legal and regulatory uniformity across the region or how we could support a consortium, I think, pilot, maybe that goes across the region. Do you have any thoughts or suggestions on anything we could do that would be particularly effective with this issue?

Mr. MOWLA. Thank you for the question. I think, as I stated before, dialogue is very important. Being in the region to CODEL was a prime example of doing so by having regulators, banks in the region, meeting their different counterparts in the Caribbean, and understanding that yes, this is about business, but it is also about personal lives, about quality of life, and having that personal relationship is very, very important.

Technical assistance, not just being in the embassies in the Caribbean, but across the Eastern Caribbean, only where they usually are only worked out of because of Barbados being in some of the smaller islands that are maybe not part of CARICOM. Building a consortium, yes, making sure that policies are harmonized. Harmonized, yes, but also contextualized to the different circumstances of each Caribbean country, even subregions as well.

The Atlantic Council is currently alongside some of our partners here on the panel, looking to promote a U.S.-Caribbean banking forum alongside CAB, alongside FIBA, alongside a lot of other organizations that have been in the space for the past decade. Ensuring that there is a space for dialogue, that there is a way for U.S. regulators, U.S. legislators to go down to the region on an annual basis to ensure that there is much more harmony between what we are essentially talking about is just access to the global financial system, access to be able to buy food, access to be able to buy goods, access to affordable healthcare, and to purchase healthcare outside of the Caribbean region.

Mrs. BEATTY. Okay. I want to thank you for that, and I think the key word is, "communicating." Look, this is not new. I can remember coming on to the Financial Services Committee, and meeting with the World Bank, and talking about the same issues with remittances and how much money we could withdraw from accounts to send back home. One of the things that we are hearing is that there has been this whole list of evaluating nations' risks deals dealing with money laundering and the financing of territories, and these lists certainly flag certain countries, many of which are the island nations in the Caribbean, as high risk and in need of greater monitoring.

Can you tell me, Ms. Delmar, how we can come up with a better system or any ideas you can give us to help us be able to properly assess money laundering? How do we assess this and the risks objectively and fairly, because I do believe that it is unfair. I do believe that just as we deal with systemic racism in our countries, there are things that happen that are not just, and I know Chairwoman Waters has some legislation. I only have a few seconds left, so you may have to respond in writing to me.

Ms. DELMAR. Okay. Thank you so much for the opportunity. Certainly, I think that there is a place for the INCSR report. I think, unfortunately, as it is being utilized now, it does not allow us to get the full gist of what is happening in the Caribbean, how we are actually fighting and combating the scourge of anti-money laundering and terrorist financing. I would be more than happy to submit to you a more formal response in respect of time, but certainly I think that this perhaps is an actual gateway to addressing and understanding a little bit more of the specific nuances of each Caribbean Island. Thank you.

Mrs. BEATTY. Thank you, and thank you, Madam Chairwoman.

Chairwoman WATERS. You are certainly welcome. Thank you. The gentleman from Guam, Mr. San Nicolas, is now recognized for 5 minutes.

Mr. SAN NICOLAS. Thank you very much, Madam Chairwoman, and thank you so much for hosting this hearing, and thank you to the panelists also for your excellent presentations. I wanted to begin by making it very plain that Guam and the Territories of the United States empathize with you. We get blacklisted multiple times, usually by the European Union. It is very frustrating, especially being a member on this committee and having to contend with the European Union blacklisting us for being a money laundering risk and a terrorism financing risk. And our own banks in our Territories, including Guam, are FDIC-insured, are regulated by the Treasury, and are regulated by the Comptroller of the Currency. We have all the trappings of U.S. options, and yet we suffer circumstances very similar to yours. And so, I wanted to first begin by thanking Chairwoman Waters for having this hearing to call attention to this issue, and to also put on the record the circumstances of our U.S. Territories that are very much the same as our brothers and sisters in the Caribbean.

My question is pretty simple, and it is related to something that we contend with on our end. If a U.S. Territory, which is part of the U.S. financial system, is still suffering the consequences of being blacklisted by these so-called watchdog types of operations, how does the Caribbean propose to be able to remedy their circumstances when Territories of the United States themselves are suffering the same? I guess I will pose it to Ms. Delmar.

Ms. DELMAR. Certainly, there are challenges for us in wrapping our minds around, how do we consistently get ourselves off of these blacklists, as you are clearly experiencing as well in Guam. We continue to ensure that we highlight the positives that are being done in the Caribbean region from a legislative perspective. We continue to be open to dialogue. Opportunities like this are not missed by the Caribbean. But it really boils down to whether or not, like we previously said, there is adequate communication and understanding the nuances that govern the various jurisdictions within the Caribbean.

We have islands now that are subject to U.S. law, where we have Caribbean islands that are subject to European law just by virtue of the fact that we were established in more instances than not under the U.K. systems. So, I think it is something that has to be dealt with as a common good, that has to be seen as a common opportunity by the European watchdogs, as you put it, as well as the U.S. Government, and the members of CARICOM, and the wider Caribbean in ensuring that we are able to outline succinctly the ways in which the Caribbean will be viewed. And that comes across also in the written submission provided by the Caribbean Association of Banks.

Mr. SAN NICOLAS. Thank you for your response. Does anyone else on the panel wish to add to the question or the conversation?

Ms. SHETRET. I would like to add in two quick points, please. One is that the methodology that is used to assess a particular jurisdiction being put onto a particular list can absolutely be revisited. There is an opportunity to look at the methodology not just from an anti-money laundering and counterterrorism finance perspective, but to consider other components, for example, the stage of development of that country. Is there a famine in that country? What is the financial inclusion methodology that could also be coupled into that so that there is more of a holistic approach to methodologies that put particular countries and jurisdictions on lists?

The other piece is that there needs to be a strengthening of a dispute resolution or an ombudsperson capability of getting removed off of that list, so that once you are on the list, it doesn't need to take years and years to get off the list. What are some ways in which parliamentary action, swift action could potentially get you an expedited removal from the list to hopefully remediate any potential concerns, reputational concerns that the jurisdiction is absorbing?

Mr. SHAH. I would like to add, from the industry perspective, that every time one of these lists gets updated and we see some islands on there, some countries on there, we ask the question, what is the consultative process and communication for you to get on the list? Is somebody making these decisions in a vacuum? Where is the communication? How do you have a dialogue to verify that these countries need to be on the list? That is one thing I would think from an industry perspective makes sense, that before somebody gets on a list, just like we are trying to do with the INCSR report, let's have that dialogue. Let's have that confirmation and make sure that the place on the list is deserved.

Mr. SAN NICOLAS. My time has expired, Madam Chairwoman, but those are all excellent points that I very much support. Thank you very much for the opportunity.

Chairwoman WATERS. Thank you very much. The gentlewoman from North Carolina, Ms. Adams, is now recognized for 5 minutes.

Ms. ADAMS. Thank you, Madam Chairwoman, for hosting today's hearing. Most of the correspondent banks are the largest financial institutions, like your bank, Mr. Shah, Wells Fargo, and others, including Citibank and Bank of America. There are some small financial institutions offering this service, but it is not too common. I would imagine that is because it is expensive to maintain the overseas staff and branches, and because the anti-money laundering and sanctions compliance is expensive. Mr. Sharma, Mr. Shah, Ms. Shetret, is it a good idea to facilitate the entry of more small and medium-sized financial institutions into the correspondent banking services, and if so, how do you think Congress can help facilitate that entry? Mr. Sharma, do you want to go first?

Mr. SHARMA. Yes, thank you very much for the question. I absolutely agree that smaller and medium-sized institutions should certainly be encouraged and facilitated, both by way of regulatory as well as legislative enablements and encouragements. In addition, as several of us talked about earlier, the advent and innovation of non-bank financial services, web-based applications that are actually providing access also give a very good opportunity to provide direct access for cross-border payments that are either remittance bound, corporate payments, and trade finance. And some of these innovations actually do not require the dependencies on global clearing banks, or custodians, or correspondent banks at all. And I think that part of the Stablecoin Act, part of the work that this committee has been doing in looking at digital assets and blockchain-enabled financial services can absolutely stimulate those while also enabling and reinforcing U.S. dollar strength, especially with respect to U.S. dollar-backed digital currencies that also serve to enable immediately small and medium-sized institutions in the United States.

And I would say finally that we already have a great opportunity to do so by some of the comments that were made earlier, the diaspora communities and those regions of the country that have direct connections to Caribbean nations. Those diaspora communities, be they small businesses or households, can be enabled for direct connections for financial access in ways that are enabled. And I would also look to—

Ms. ADAMS. I want to move on and give some time to Mr. Shah.

Mr. SHARMA. —CRA and other enablements that way, too.

Ms. ADAMS. Okay. Thank you. Mr. Shah?

Mr. SHAH. When you look at the environment for correspondent banking, usually the large banks have a significant infrastructure and program to manage those risks. It is always a good idea to have many providers of the service. Small and medium-sized banks would also have to invest in a similar infrastructure and program, and also be able to respond to the regulators like a big bank would. From my perspective, it is always a good idea to have more and more folks providing the service as long as they can manage the risks appropriately.

Ms. ADAMS. Okay. Ms. Shetret?

Ms. SHETRET. I agree with what has been said so far. Thank you.

Ms. ADAMS. Okay. Thank you very much. Let me ask Mr. Sharma, can you briefly discuss how new fintechs are playing a role in the correspondent banking space in the Caribbean?

Mr. SHARMA. Absolutely, and I want to commend a previous panelist, the Prime Minister from Barbados. Barbados and many other Caribbean nations are exploring the use of technology, particularly blockchain technology, for purposes of asset issuance—in other words, digital assets, including central bank digital currencies. Secondly, the ability for peer-to-peer payments directly that do not require a specific financial intermediary that enables both the secure and equitable access between counterparties, again, corporates and otherwise, and that innovation is being seen in the Caribbean, in particular.

A previous question on how Caribbean nations can actually prove what they are doing to provide security and risk should also assess the level of inclusion opportunities that are provided, including through the use of financial technology applications, and that should be leveraged, that should be assessed and considered when thinking about the security risk management, AML, and other considerations that they are actually undertaking because some of those innovations are, in fact, providing inclusion and greater transparency in tandem. Those are some examples.

Ms. ADAMS. Thank you, sir. I am out of time, Madam Chairwoman, so I yield back.

Chairwoman WATERS. Thank you so very much. The gentleman from Wisconsin, Mr. Steil, is now recognized for 5 minutes.

Mr. STEIL. Thank you very much, Madam Chairwoman. Ms. Shetret, we have spoken today about the breakdown of correspondent banking relationships and its impact on Latin American and Caribbean countries, rightfully so, but these also are one-sided. And I would love for you to shed a little light about the other end, the correspondent banking relationships with U.S. financial institutions that facilitate business with American companies. And can you talk about how American businesses and workers would be impacted when international financial flows would be disrupted?

Ms. SHETRET. I'm sorry, could you clarify the question?

Mr. STEIL. We have a little bit of noise there with the door, but we have talked about the impact that this would have on Latin American and Caribbean nations. What is the impact here in the United States of America, the other side of the coin, if you will?

Ms. SHETRET. Yes. One of the things that we are seeing here is that there is a brain-drain innovation, and things are not quite flourishing as much as we would like to see, because, essentially, businesses are moving to where they can operate openly and freely, and that is difficult to see. America is a wonderful place to innovate, and we would like to keep that in this country, so there is a concern around brain drain there. The other piece is that the regulatory framework requires a little bit more adjustment to be clear and to allow for innovation to bloom here, and that is something I would point out.

Mr. STEIL. Thank you. Let me continue on with you. In your opening statement, you spoke about how de-risking is, I think, "perpetuating the challenge of regulatory arbitrage." Can you explain how this dynamic plays out, and does aggressive de-risking from the U.S. potentially yield global financial flows to countries such as China, which may have very different standards?

Ms. SHETRET. The concern of regulatory arbitrage is real, and what happens is that there is no standardization globally that is being enforced. What we see is that one country implements particular frameworks that then doesn't get translated. This impacts the opportunity to investigate, to share information. The criminal codes are different. The legislation varies, and there is no common language. Sharing information under very complicated memorandums of understanding becomes an ordeal. It is not timely. This is particularly difficult when we look at governments that are not necessarily cooperative with international frameworks; we do require information sharing because criminality does know no boundaries or barriers, and we do need information sources around the globe.

One of the things that we have been seeing is that the ambiguity of the risk-based approach, national regulators are coming out to put more detail behind that, but that is happening at a different pace. It is happening at a different speed and at a different level of detail across countries. So, I do hope that the Financial Action Task Force and its counterparts by region, for example, in the Caribbean, the Caribbean Financial Action Task Force will spend more time kind of putting those details behind expectations around how to manage high-risk customers.

Mr. STEIL. Thank you. Let me shift gears somewhat here with you. When we look at ways to mitigate the impacts of broad-based de-risking, I think it is important to consider the role that digital currencies can play in bringing marginalized regions safely back into the financial system, and this is especially true for island nations where it is more challenging to move physical currency. One concern that is often brought up, I think incorrectly, is that cryptocurrency can't be part of the solution in this, and some will make arguments that crypto is a conduit for illegal activity. I disagree with that premise. Do you think crypto, in particular, presents an outside risk with respect to illicit finance?

Ms. SHETRET. I disagree with that premise as well. Thank you for sharing that. I think that criminals are opportunistic. They will go wherever they can manage loopholes, wherever they see gaps. And we see that they have been successfully utilizing all sorts of instruments globally, including the traditional financial sectors. And it is not a surprise that they are also using crypto in the virtual asset space, non-fungible tokens as well to act. But what we have seen by and large is that because of the capability to trace illicit finance, we actually have eyes and ears on the ground, so to speak, as to where illicit financing is ongoing. The capabilities of prescreening are really helping us understand where it is happening so we don't cash out. There are opportunities with crypto specifically that allow companies and centralized exchanges that are regulated to stop transactions that they see are illegal and illicit.

Mr. STEIL. I agree with you that crypto provides opportunities to actually mitigate the impacts of de-risking.

Ms. SHETRET. Absolutely.

Mr. STEIL. Recognizing the time, Madam Chairwoman, I yield back.

Chairwoman WATERS. Thank you. The gentlewoman from Massachusetts, Ms. Pressley, who is also the Vice Chair of our Subcommittee on Consumer Protection and Financial Institutions, is now recognized for 5 minutes.

Ms. PRESSLEY. Thank you, Madam Chairwoman. As the Representative of the third-largest Caribbean diaspora in the United States, this hearing really resonates deeply with me. In my district, the Massachusetts 7th, many of my constituents, many of my neighbors send remittances to their families in Haiti and throughout the Caribbean, which have really proven to be a lifeline amidst the financial hardships of the pandemic and, of course, global inflation as well. Remittances help working-class families stay afloat when they need it the most and have demonstratively reduced poverty in several countries.

Mr. Mowla, according to the Atlantic Council report, which you co-authored, the Caribbean has seen a decline in correspondent banking relationship since 2015, with the World Bank citing the region as the most severely affected by this phenomenon from a global perspective. As a result, remittances to my constituents and to their families have become more expensive, if not denied or delayed entirely. Can you please expand upon how the decline in correspondent banking relationships is harming working-class families in the region? I just wanted to build upon that question from my colleague, Congressman Meeks, earlier.

Mr. MOWLA. Thank you for the question. Mostly, as I mentioned to Congressman Meeks, remittances supplement working-class populations' incomes. It is what people use, especially when there is job loss and poverty. We saw this with the pandemic, where 10 CARICOM countries have tourism-dependent economies. During the pandemic, tourism shut down, which meant that they were unable to go to work. Where were they able to get an income supplement to buy food, to purchase healthcare, to access education? It came from remittances. We saw this in Haiti. We saw this in Jamaica.

Now, the pandemic was just 2, 3 years, still ongoing, but we think about disasters and extreme weather events. Remittances help. They help with taxes. They help across-the-board. At the same time, remittances, when they are delayed, when they are much more costly, it affects the people who are in the U.S. itself. They are then going to be unable to send remittances, and they themselves, especially people in Massachusetts, New York, and Florida, who are already living in sort of underserved communities, are going to have to pay more and more each time.

Ms. PRESSLEY. Thank you. Again, I would like to explore this a bit more. For countries like Haiti and Jamaica, we know that remittances accounted for 20 percent of their GDP in 2020 alone. So if the decline in correspondent banking relationships continues, what will be the impact on these nations' economies?

Mr. MOWLA. For countries like Jamaica, it is 20 percent of the GDP, but then you have tourism, which is about 25 percent of GDP, so almost half of their GDP has been wiped out during the pandemic. And when there are limited remittances, what happens is that when you have limited economic stability, it can create political instability. When people don't have jobs, when people are impoverished, they have to find other ways of making money. It can lead to sort of petty crime. Women and children are disproportionately affected. They can become victims of human trafficking. It creates broad political instability when you couple that with other factors such as climate change, energy insecurity, and high food prices. This creates a very worrisome picture in the Caribbean, especially over the long term.

Ms. PRESSLEY. Worrisome, devastating. And for a region disproportionately vulnerable to climate disasters and dependent on the tourism industry, finding a solution to this de-risking problem is really critical. Mr. Mowla, in the report you co-authored, you listed a number of possible solutions to this problem. Specifically, you discussed categorizing correspondent banking as critical market infrastructure for the important role these relationships play in Caribbean economies. Can you elaborate how this categorization would increase access to financial services in the region?

Mr. MOWLA. Yes. Both in the U.S. and globally, it would identify correspondent banking as a global public good, as a human right basically. As Prime Minister Mottley stated in the previous panel, doing this will give added justification for international financial institutions to incorporate correspondent banking as critical market infrastructure in development packages and development finance, and USAID assistance after extreme weather events. It also helps to sort of underscore the vulnerabilities that these countries are facing, even high- and middle-income countries, allowing them another justification to be able to access concessional financing and blended finance as well.

Ms. PRESSLEY. Thank you, and thank you to our distinguished Chair for this historic hearing. This is certainly an issue of critical economic, racial, and immigrant justice, and we can't sit idly by.

Chairwoman WATERS. Thank you. The gentlewoman's time has expired. The gentlewoman from Texas, Ms. Garcia, who is also the Vice Chair of our Subcommittee on Diversity and Inclusion, is now recognized for 5 minutes.

Ms. GARCIA OF TEXAS. Thank you, Madam Chairwoman, and I want to thank you for bringing this very important topic to the table. I, too, was on the trip with you when we visited Barbados and the Bahamas and started looking at this issue. It is good to see the Prime Minister back. It is good to see so many of you that we met during that trip, and we hope that we can build on this and come to some solutions and some legislation that would be of assistance. I wanted to start with Mr. Sharma, Mr. Shah, and Ms. Shetret.

Most of the correspondent banks with the largest financial institutions, like your bank, Mr. Shah, Wells Fargo—and I was really pleased with the remarks you made earlier. And of course, we also included Citibank and Bank of America. There are some small financial institutions offering services, but it is unusual, I would imagine, just because it is expensive to maintain the overseas staff I think you all talked about during the forum, and our branches because the anti-money laundering and sanctions compliance is expensive. I think the Prime Minister mentioned that. It is a good idea to facilitate the entry of more small and medium-sized financial institutions into correspondent banks. Do you think we need to do more of that, or what specifically do you think, Mr. Shah, we need to be doing to help to just get more banking in the Caribbean?

Mr. SHAH. When you look at some of the reasons outlined for banks leaving, there were largely three major reasons. The first one was that the Caribbean was now recognized as a high-risk jurisdiction for a multitude of reasons and maybe the wrong perception. That was the catalyst that basically said, if I am going to be in a high-risk jurisdiction, it is easier for me to exit than to mitigate the risks, because operating in that jurisdiction will require an immense amount of resources and investment.

The second thing that a lot of the banks looked at is how well did the region itself respond to new legislation and the ability to mirror risk appetite with U.S. financial institutions, so that was the second challenge. And when we talk about encouraging banks to go back in there, there is this notion and everybody talks about it, the risk-based approach. So for a small or medium-sized bank, their view on a risk-based approach for correspondent banking might be totally different from a bank that has a program equipped to manage correspondent banking risks. I think small banks going in there need to be wary that they face the same challenges larger banks face.

Ms. GARCIA OF TEXAS. Right. As you may recall, during that forum I mentioned that, to me, just listening to all of you, it reminded me a lot of the challenges I have with bringing banks into my district, which is 77-percent Latino, very heavy with Spanish-language speakers, because banks are really not interested in having branches in some parts of Houston. You were sort of redlined. And similarly, it appears that you all have been redlined from the U.S. banking system. To quote the Prime Minister, I do see you, and I do hear you, and I feel you, and I think we are committed to making some changes, and again, to focus on how similar it is. We don't want to duplicate in any changes any of the exclusionary regulations. We need to be more and more about being inclusive. And I wanted to ask Ms. Delmar, can you be more specific about how de-risking practices impact remittance payments?

Ms. DELMAR. Certainly. As far as the cost of remittances goes, it is one of the major factors that impedes the ability to send money back home to families. The other thing that we need to be mindful of that is remittances form part of the core of our existence in the Caribbean region. We have a number of families whose children go to school in the United States, and it is tantamount to their survival that we are able to transfer money between the countries, between the jurisdictions. The cost of remittances at this stage is highly prohibitive, and it has a resultant impact on the overall operational expenses of the Caribbean banks, the majority of which now are also indigenous banks. So they are small banks, trying to find innovative ways of ensuring that they are able to serve the populations, and that is one of the critical areas. Of course, I am happy to provide you a written report with a little bit more in-depth responses, given the time constraints.

Ms. GARCIA OF TEXAS. Okay. Thank you. Madam Chairwoman, I would like to insert in the record a study that was made by the Texas Association of Businesses just this last year, "Anti-Money Laundering Regulation, Correspondent Banking, and the Adverse Economic Impacts for the U.S.-Mexico Bilateral Relationship," because, Madam Chairwoman, as you know, this is not just the Caribbean, although that is our focus today. It impacts all of the Western Hemisphere Latin American countries. And I thank you again, Madam Chairwoman, for your leadership.

Chairwoman WATERS. You are welcome.

Ms. GARCIA OF TEXAS. I will look forward to working with you on your bill.

Chairwoman WATERS. Thank you.

The gentleman from West Virginia, Mr. Mooney, is now recognized for 5 minutes.

Mr. MOONEY. Thank you, Madam Chairwoman. Fossil fuels are essential for affordable energy here in the United States. Under President Trump, the United States achieved energy independence. According to the major accounting firm, PricewaterhouseCoopers, the oil and natural gas industry supports 9.8 million jobs, which is 5.6 percent of total U.S. employment. Coal is a lifeline for West Virginia's economy. In the State that I am blessed to represent, West Virginia, coal supports over 29,000 jobs. West Virginia is the second-largest coal producer in the nation, accounting for 13 percent of the total U.S. coal production. Yet President Biden, as he did when he was Vice President under President Obama, has made it his mission to wage war on the fossil fuel industry. Some of his more-objectionable nominees have openly called for banks to deny financing to fossil fuel companies. De-risking is when banks limit certain services or relationships with customers to avoid regulatory concerns or problems, like money laundering.

Ms. Shetret, the current Administration has made its opinions on the fossil fuel industry very clear. Given your work on de-risking, especially in a post-Operation Choke Point world, can you explain the effects of de-risking entire industries and what impact that can have on the United States and our competitiveness?

Ms. SHETRET. Thank you for the question. To be clear, sectoral de-risking is counter guidance and counter international standards. That is absolutely not the goal of regulation, and it is not the goal of the framework that is being touted. In fact, it is quite the opposite of risk-based approach, case-by-case analysis, and so in blanketing sectors, we are actually shooting ourselves in the foot, so to speak. And we spoke about the concept of re-risking where if we do ultimately de-risk entire sectors, what happens is that risk goes elsewhere. It is re-risked into potentially smaller businesses or smaller financial institutions that can't manage the compliance burdens that come with that, or it might go into Chinese counterparts. Wherever it might go, the challenge is that the risk does not disappear, and that is the bottom line, and we run the risk of doing that by eliminating sectors altogether.

Mr. MOONEY. Thank you. The point I am making here is that everything we are hearing from our witnesses today about the effects of de-risking in the Caribbean can also be said about this current Administration's approach towards fossil fuels. For example, Ms. Delmar, you stated, "De-risking activity perpetuates the perception of the region as a high-risk jurisdiction, which in turn has an adverse effect on investor appetite." The same holds true in the United States. The Biden Administration seeks to negatively affect investor appetite and steer capital away from fossil fuel companies, while killing millions of American jobs. It is critical that we do not abandon the fossil fuel industry in this country. The so-called Inflation Reduction Act raises taxes on West Virginia's coal industry to provide subsidies for electric vehicles in big cities. That is devastating to West Virginia workers, while doing nothing to bring down energy costs. Thank you, Madam Chairwoman, and I yield back.

Chairwoman WATERS. Thank you. This is the Financial Services Committee. The gentleman from Missouri, Mr. Cleaver, who is also the Chair of our Subcommittee on Housing, Community Development, and Insurance, is now recognized for 5 minutes on financial services issues.

Mr. CLEAVER. Thank you, Madam Chairwoman. Yes, that is what I hoped we would talk about today, but there has been digression. Ms. Delmar, would it be of any value if the U.S. Department of the Treasury would work with the Caribbean Financial Action Task Force to help build a greater technical capacity?

Ms. DELMAR. Thank you for the question. Certainly, we believe that there is the opportunity to continue the dialogue so that we ensure that, again, the policies are reflective of what happens in the Caribbean islands and sets us apart from perhaps the rigorous nuances associated with these policies and legislations that are implemented in the United States?

One of the things that has to be considered in decision-making is the size and scale of the Caribbean islands and our ability to respond effectively and efficiently to the changes that we seek on a constant, ongoing basis around policy change. And so, yes, I believe it is something that we will be open to, to working with you to ensure that there are policies that are put in place that also take into consideration what makes the Caribbean a third border to the U.S., small, interconnected islands, that are, to a large extent, in more instances than one, heavily reliant on the opportunities to trade with the U.S. to remain viable vibrant economies.

Mr. CLEAVER. Thank you. I was here with our children and increasingly very few others in the aftermath of the 2008 economic collapse, but it was infinitely easier for us through the Dodd-Frank Act to deal with our entire system because all of the banks in the United States operate under the same laws and requirements. And I am just wondering, and I have become a fan of USAID—I have seen what they have done all around the world, in Africa for example, where I have many relatives, at least in Tanzania. And I am thinking that I don't know how active the USAID is in the Caribbean. I think you probably could answer that one first. Are you aware of USAID presence in—

Mr. MOWLA. Yes. They are extremely important to disaster response, especially after hurricanes, as well as currently on food security production.

Mr. CLEAVER. Yes. They do a lot of that around the world. The point I am trying to make is that USAID may be able to help build the technical capacity in the Caribbean. When you list the things that you need most desperately, I am assuming that for us to get rid of this redlining, I can't think of another blacklining, brownlining, whatever we want to call it. But it would seem to me if you know where that sits on your priority list, maybe that ought to be a request from a USAID, either from the task force or from this committee, to develop a program so that they can help build this technical capacity, but do so with some kind of standardized compliance requirements connected with Dodd-Frank.

Mr. MOWLA. I would say—

Ms. DELMAR. Sorry. From my perspective, the concern there for me would be whether or not this would be considered recognized by the regulators, the U.S. regulators specifically, noting that while we may build technical, it has to be done in conjunction with the U.S. regulators, of course, I would imagine, to ensure that it is identified, it is recognized as acceptable, so that we are re-onboarded in some instances and are able to establish relationships. And I say that in the context that the Caribbean has consistently, from 2015 up until the present day, spent inordinate amounts of money trying to figure out what are the challenges, specifically, why are we consistently being faced with the issues of de-risking? And today, we find that the conversation keeps changing in terms of what should we do, and all of these things are capital-intensive for us. But wouldn't it be better if we had standardized compliance?

Mr. CLEAVER. Yes, absolutely. And maybe that is one of the requests we need to make to USAID. My time has run out. Thank you, Madam Chairwoman.

Chairwoman WATERS. You are welcome. The gentleman from Massachusetts, Mr. Auchincloss, who is also the Vice Chair of the committee, is now recognized for 5 minutes.

Mr. AUCHINCLOSS. Madam Chairwoman, I appreciate you hosting this hearing. It has been educational for me. My questions are for Ms. Shetret on stablecoins' usage for correspondent banking. You said in page 4 of your written testimony, in a section entitled, "Innovation and Technological Solutions to De-Risking," that Congress should explore legislation to facilitate the acceleration of digital dollars. And you described that CBDCs have a high adoption rate in the Caribbean, with eight countries fully deploying one, and that if the U.S. develops our own digital dollar, it should be interoperable with other nations' CBDCs.

Now, I am a committed CBDC skeptic in terms of the United States and the Federal Reserves, the statutory authority to do it without getting Congress' approval and to the necessity of it here in the United States when we have a flourishing ecosystem of private stablecoin issuers. Can you describe whether you see any particular need for it to be a CBDC that would be interoperable with Caribbean CBDCs or whether if we mandated interoperability for private stablecoin issuers here in the United States, that would fulfill the same end state?

Ms. SHETRET. Thank you for the question. I think it is the latter piece that is important here. It is the interoperability piece of integrating into economic blocks. I think the concern whether it is a CBDC or a stablecoin is isolationism and creating a closed loop in which there is no way to conduct trade, to conduct transaction monitoring, and to be able to have visibility into risk and properly risk manage. I think the suggestion and the proposal is to essentially make sure that whichever direction we take that interoperability with the Caribbean and globally is considered front and center.

Mr. AUCHINCLOSS. Agreed. And adding to the comments from my friend from Ohio, Mr. Gonzalez, the stablecoin has tremendous potential to amplify the U.S. dollar as the world's reserve currency, which has been a huge source of strength for us really since World War II. I want to give you the floor for maybe 30 seconds to a minute, as well as any of your fellow witnesses, who want to jump in here. Let's imagine that we have a scenario where stablecoins are interoperable and are properly collateralized both in the Caribbean and the United States, how might they assist with correspondent banking and/or the facilitation of remittances?

Ms. SHETRET. The first piece of stablecoins I would like to emphasize is the power of financial inclusion. It enhances the opportunity for accessibility to services that, at the moment, the unbanked or the de-banked don't have access to, and that is a huge win. We, with correspondent bank de-risking, have created an exclusionary barrier that stablecoins will allow us to overcome. I think the other piece that comes with that is that, again, it allows us to do anti-money laundering, counterterrorism finance, transaction monitoring, customer due diligence, all of the things that we need to be doing more efficiently, and more effectively. It is faster. It is potentially cheaper if we leverage technology properly. I think I will allow other colleagues to share their views, but that would be my bottom line.

Mr. SHARMA. Yes. I will just add a couple of things. I agree entirely with what Ms. Shetret has just said. The underlying technology that facilitates stablecoins provides through its attributes the immutability of ledgers, and the traceability of transactions in much of the sector. And I believe that it is very additive to the broader financial services economy insofar as both inclusion metrics for direct access as well as to alleviate leakage, waste, fraud, and abuse, because again, the underlying technology provides some of those capabilities from an anti-money laundering perspective as well.

Mr. AUCHINCLOSS. Mr. Shah and Ms. Delmar, do you want to jump in about the ability of stablecoins or the underlying technology to assist or augment correspondent banking?

Mr. SHAH. When you look at some of the major risks, the actual mode of transmission of transactions is not really the number-one issue. Ultimate beneficial ownership, figuring out whom you are doing business with, the type of transactions, whom you bank, and whom you choose not to bank, those are some of the things that still continue to remain challenges, regardless of whether you use hard currency or digital currency.

Ms. DELMAR. And I am also inclined to agree with Mr. Shah's perspective, that we would need to do a bit more investigation into ensuring that if this becomes the option or an opportunity, that it actually addresses the issues posed by correspondent banking.

Mr. AUCHINCLOSS. It is not a solution in search of a problem in other words, as I fear that the U.S. CBDC would be. Thank you, and, Madam Chairwoman, I yield back.

Chairwoman WATERS. Thank you very much. I am so pleased that Prime Minister Mottley came today and she not only set the stage for, but participated with us being able to move forward with an illuminating discussion. I do believe that we face the issues, that the discussion was well-thought-out and well-presented by all of you on the second panel, and I am very optimistic, as a matter of fact. I think I almost joined with someone on the opposite side of the aisle in ways that I never thought I would, to deal with this issue. And so, I want to thank the second panel for being here, for the time that you have spent, and to say absolutely, again, thank you for your testimony today.

The Chair notes that some Members may have additional questions for these witnesses, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

The hearing is adjourned.

[Whereupon, at 1:38 p.m., the hearing was adjourned.]

A P P E N D I X

September 14, 2022

Written Testimony of Wendy Delmar

Chief Executive Officer, Caribbean Association of Banks Inc

House Committee on Financial Services

"When Banks Leave: The Impacts of De-Risking on the Caribbean and Strategies for Ensuring Financial Access."

Wednesday 14 September 2022

Chairwoman Waters, Ranking Member McHenry, other distinguished members of the Committee I bid you all a good morning. Before I begin my testimony in earnest, I would first like to express my sincere gratitude to all who made today possible and for providing me an opportunity to shed light on a matter that may be deemed as the proverbial "thorn in the side" for banks and other financial institutions in the Caribbean. As a Caribbean national and career banker for over two decades, the onslaught of de-risking activity and its resultant adverse impact on the banking industry and economies of the region has been both disheartening and deeply concerning.

In my capacity as Chief Executive Officer of the Caribbean Association of Banks Inc. (CAB)[1] - which is the representative body and recognised voice for banks and other financial institutions in the Caribbean - I am proud to state, that the CAB was the first regional organisation to sound the alarm as early as 2015 relating to de-risking activity in the Caribbean. Since then, we have worked assiduously to bring to the forefront the challenges faced by the region resulting from the loss of correspondent banking relationships, while concurrently striving to identify possible solutions. I believe that today's special Hearing is testament that our advocacy and similar endeavours by other organisations did not fall on deaf ears.

It is now widely agreed that prior to the increase in regulatory requirements aimed at addressing money laundering and the financing of terrorism, banks and other financial institutions within the Caribbean enjoyed mutually beneficial correspondent banking relationships with United States correspondent banks. However, as noted by Ian De Souza in a 2017 research paper commissioned by the CAB entitled *Correspondent Banking and De-risking in the Caribbean - The Unintended*

[1] The Caribbean Association of Banks Inc. (CAB), formerly the Caribbean Association of Indigenous Banks (CAIB), was established in 1974 by the Chief Executive Officers of nine national commercial banks within the Commonwealth Caribbean.

Consequences of Regulatory Guidelines and the Threat to the Indigenous Banking Sector "…the scaling up of efforts related to anti-money laundering and combating the financing of terrorism ultimately resulted in a deteriorated cost-benefit analysis position for the business of Caribbean banks and other financial institutions wherein, the provision of correspondent banking services was no longer deemed profitable." In simple terms, the risks associated with the provision of correspondent banking services to respondent banks in the Caribbean now far exceeded the reward.

Yet, regrettably, and quite candidly, the current arrangements through which the international financial system has chosen to relate to Caribbean banks and other financial institutions has rendered the region disproportionately dependent on correspondent banking services. Consequently, the adverse effects of de-risking are exacerbated.

To establish a better appreciation for the direct impact of de-risking on the Caribbean, I will expand on the foremost areas of concern highlighted during consultations with CAB members across the region.

Impact and Effects of De-risking

- Increased operational costs

In nearly every instance, banks within the region regardless of the termination of correspondent banking relationships have highlighted significant increases in operational costs driven almost entirely by compliance related initiatives. While some expense may be warranted to ensure that industry best practices and standards are adhered to, it is equally important to acknowledge the tremendous burden inadvertently placed on the region's banks to discredit the relentless propagation of the Caribbean as a "high-risk" region. Over the past seven years, most banks have had to undertake extensive training and re-tooling of staff in addition to the implementation of more sophisticated transaction monitoring platforms, all in an attempt to satisfy the requirements of correspondent banks. This increase in operational costs has significantly and negatively impacted the profitability of many of the smaller indigenous banks throughout the region and has stymied future growth and expansion, which should not be overlooked.

- Perpetuation of shadow banking

As banks and other financial institutions implement the necessary processes and procedures in keeping with established anti-money laundering and combating the financing of terrorism regulations, the cost per transaction has increased. Further, there have been observed fee hikes related to correspondent banking services, such as in the facilitation of wire transfers. This negatively impacts customers and clients who ultimately bear these increased costs. As a result, challenges reaching the unbanked are exacerbated and already established participants of the financial services industry are likely to reduce their level of participation. Moreover, by way of example, individuals using banking services to remit money to their respective island nation states to support family and friends are inadvertently influenced to seek out other ways of transacting, thereby limiting the ability of banks and regulators to track remittances through legitimate sources, adding yet another layer of complexity to the challenges already identified.

In the case of Belize, which was acutely impacted by de-risking activity, the loss of nearly all correspondent banking relationships resulted in the inability to provide wire transfer services, the processing of credit card payments and the clearing of cheques issued by United States banks. The latter continues to be unresolved at present.

- Reduced appetite for foreign direct investment

Given that the Caribbean comprises the world's largest grouping of small island developing states (SIDS) and noting the distinguishing differences between SIDS and other economies, the contribution of foreign direct investment (FDI) to the gross domestic product (GDP) of Caribbean economies is substantial. De-risking activity perpetuates the perception of the region as a high-risk jurisdiction, which, in turn, has an adverse effect on investor appetite. This reduction in FDI has a multiplicity of ramifications from a reduction in GDP and employment opportunities at the macroeconomic level, to increased poverty and dependence on social protection programmes (which are not as comprehensive as those available in more advanced economies) on the microeconomic level.

- Limited participation in international trade

SIDS, have very limited resources and invariably are heavily dependent on international trade and concomitantly on international financial markets to clear payments for imports and exports. Most Caribbean jurisdictions are net importers. Consequently, the availability and access to goods from grocery store items to vehicles is dependent on well-functioning correspondent banking relationships. Hence, any disruption to the previous (as is the case with de-risking activity) has the potential to disrupt international trade with far reaching consequences.

In addition, I would also like to draw attention to the annual International Narcotics Control Strategy Report (INCSR) which has proven to be a source of great disquiet for not only members of the banking community but the wider Caribbean populace. During stakeholder engagements, several CAB members have highlighted the detrimental and erroneous representation of their respective jurisdictions as contained in the contents of the INCSR. While I appreciate that this may not be the Committee responsible for the development and publication of the Report, I wish to commend Chairwoman Waters for her interventions which have resulted in proposed amendments to the text of the INCSR. These amendments, if successfully adopted, will increase the validity of the Report and hopefully result in a more factual and less disparaging representation of the Caribbean region.

It should also be noted, that based on the first-hand accounts of banks that suffered the termination of long-standing correspondent banking relationships (in some instances) the reason(s) for the termination of the relationship is not explicitly stated (please refer to Document A attached). The respondent bank is therefore left with little to no guidance as to what steps may be undertaken to remedy the relationship.

Strategies for Improvement

Having appreciated the foregoing, I wish to provide the following strategies for improvement for consideration by the Committee.

1. Development and implementation of common and preset international compliance standards.

Given the fast paced rate at which compliance requirements are changed (often with little to no justification) banks and other financial institutions within the Caribbean are left to pursue a continually moving goal post. This ultimately results in burdensome and excessive expense to satisfy the new requirements which stifles business development and expansion.

2. The consideration of correspondent banking services as an economic and humanitarian good.

The significant contribution of well-functioning correspondent banking relationships to the operations of the banking sector and the economies of Caribbean jurisdictions cannot be overstated. To phrase it frankly, without the availability of correspondent banking services, the region would be entirely prohibited from conducting any international business or transactions. In an ever-more globalised world, the ramifications of such a reality to the people of the region are inconceivable.

3. Support of a regional approach to improve the cost-benefit position of respondent banks.

It is an unavoidable reality that some of the smaller banks within the region have insufficient volumes of transactions to render the profitable provision of correspondent banking services. In this regard, the favorable consideration of efforts aimed at the pooling of transactions via inter-bank relationships (among jurisdictions) or through an established regional mechanism is solicited.

4. Improved provision of information to inform the International Narcotics Control Strategy Report (INCSR).

Given the previously highlighted concerns regarding the INCSR, it is recommended for consideration, that key resource persons and or agencies (such as Financial Intelligence Units or Financial Services Regulatory Authorities) be consulted or engaged for tangible contributions towards the content of the Report. In so doing, the risk of misrepresentation of the respective jurisdictions is decreased.

Chairwoman Waters, Ranking Member McHenry and other members of the Committee these are but a few of the foremost areas of concern for banks and other financial institutions in the Caribbean regarding de-risking. The suggested strategies for improvement are in no means intended to be exhaustive, therefore, further dialogue is welcomed.

Thank you once again for an opportunity to share on this matter today.

STATEMENT BY

THE HONOURABLE MIA AMOR MOTTLEY

PRIME MINISTER OF BARBADOS
MINISTER OF FINANCE, ECONOMIC AFFAIRS AND INVESTMENT AND MINISTER OF NATIONAL SECURITY AND CIVIL SERVICE

AT THE HEARING OF THE UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES

ENTITLED

"WHEN BANKS LEAVE: THE IMPACTS OF DE-RISKING ON THE CARIBBEAN AND STRATEGIES FOR ENSURING FINANCIAL ACCESS"

SEPTEMBER 14, 2022

Executive Summary

In the United States, 30% of the earnings of the 'S&P 500' list of corporations come from overseas. International payments are critical even for the largest economy. Smaller countries, like those in the Caribbean, rely even more on exports and foreign income to pay for imports and payments abroad. These cross-border flows, approximately $150 trillion annually, come through correspondent banks that place deposits with each other. This network underpins the international economy.

But critical gaps and fragilities have emerged. A group of countries are losing their correspondent banking relationships. The consequences are deep and broad, ranging from higher business costs, lower economic activity and arrested development. The fear of losing correspondent relationships has created a highly risk-averse culture, worsening these impacts and causing a decline in financial inclusion for the first time in our history. And, it will force legitimate transactions underground, giving life to unregulated international payment systems that will create a national security problem for the United States and other countries. It has, for instance, powered the spread of unregulated crypto exchanges and could draw countries towards the digital-yuan issued by the Peoples Bank of China as a cheaper, less restrictive alternative system of international payments. As things fall apart at the edge, the centre will not hold.

New technology is a small part of the story of correspondent banking consolidation. The more significant element is the active decision of correspondent banks to leave certain jurisdictions. Forty countries have lost more than 40% of their correspondent banking relationships; 20 countries, many in the Caribbean, have lost over 50%. Some, like Belize, are down to just a few connections. According to the Bank of International Settlements (BIS), eight countries cannot receive any payments; four cannot send.

Correspondent banks are leaving these jurisdictions because the Financial Action Task Force (FATF) has listed them as countries requiring increased monitoring against money laundering. This is not because they have found any material international money laundering there. But additional monitoring causes additional costs, primarily fixed per jurisdiction and so disproportionately higher per transaction in small jurisdictions. Where profits are small, these increased costs make the business unviable. And if a financial institution is fined for missing money laundering in a jurisdiction, these fines are often related to the size of the institution, not the profits from the jurisdiction, further worsening the attractiveness of small jurisdictions. A Bank for International Settlements study shows that the best predictor of a loss of correspondent banking relationship is if the FATF has listed a country and the volume of transactions is small.

On average, listed countries spend more of their GDP on anti-money laundering processes and consultants than large developed economies, but this has little impact because the FATF list is divorced from where international money laundering occurs. It is not, for instance, where the vast majority of laundering of sanctioned Russian money was found, in the United Kingdom, United States, Switzerland and Luxembourg. None of those countries appears on the current FATF list. It is based on being judged deficient in expensive processes and procedures which, when spread across transactions, are cheaper for large money centres. And when few countries are left on a list over time, the criteria for listing and requirements change. This costly compliance process, which US consumers of financial services and others pay for, results in the listing of countries that pose no risk to the integrity of the global financial system such as Barbados, Burkina Faso, Jamaica, Mali, Senegal, and South Sudan. Larger money centres that money launderers prefer to lose themselves in are never on the list. This supports money laundering. After trillions have been spent on this process, there is more money laundering, not less.

But it also means there is a simple solution. The United States Treasury participates in the FATF and the listing process. Treasury states that it believes in objective and risk-sensitive listings. An outcome that requires climate vulnerable countries like Senegal and South Sudan to spend scarce money getting off a list they should not be on, but gives a pass to Luxembourg and Switzerland, is untenable.

We ask Treasury to adhere more closely to the principle of risk sensitivity and not to participate in listings of countries where the lists pose a material risk to a country's development and where there is no evidence that the country poses a material risk to the global financial system. This will protect financial inclusion locally and internationally, guard the international network against underground alternatives, and toughen the fight against money laundering. It will turn the big guns away from countries where little money laundering occurs to those where much does. Perhaps that is why it is not happening.

Introduction

1. Globally, the exchange of money for products and services is at the core of how our economies function. There are millions of transactions conducted daily that enable households, firms and governments to buy essential goods and services. Large and small countries alike depend on a well-functioning financial settlement system to facilitate economic growth and financial stability.

2. The increased international mobility of goods and services, capital and people has contributed to the growing economic importance of cross-border payments. Some analysts forecast that the value of cross-border payments will rise to over $250 trillion by 2027.

3. The island economies of the Caribbean are small on a global scale. Individual islands lack diversity in their production base and they are vulnerable to economic shocks and to climatic events. They depend more heavily on external trade in goods and services to spur economic growth, create jobs, reduce poverty and promote economic stability. Through tourism, commodity exports, foreign investment, remittances and the demand for imported goods, foreign exchange flows serve as the engine for growth.

4. Most of these transactions are denominated in US dollars and other globally traded currencies. Access to correspondent banking services in the United States and other advanced economies is crucial, including for cash management, international wire transfers, cheque clearing and foreign exchange services.

5. Financial institutions in the region therefore need ready and constant access to such services to enable them to facilitate cross-border trade and investment and to assist governments to address the economic challenges faced by the region.

6. Access to correspondent banking services links the region to the rest of the world, demonstrating the interdependence of nations, whatever the size of our respective economies. Access enables financial inclusion and creates an environment for ensuring that regional economies are not left behind. On the other hand, lack of access compromises the competitiveness of regional economies, slows the journey on the path to development and creates the risk of socioeconomic problems.

7. COVID-19 has set back regional economic development, especially in economies dependent on the export of tourism services. The current inflationary spiral, caused by disruption to the global supply chain and the Russia-Ukraine conflict, makes access all the more critical in the aftermath of the economic impact of COVID-19.

8. Over the past decade, Caribbean countries, like other jurisdictions, have been experiencing the scourge of de-risking by their correspondent banks. Several regional financial institutions have experienced restrictions on or lost access to entire correspondent banking relationships (CBR). In

some cases, it was the institution's only CBR and some entities have had difficulty in replacing some relationships. The adverse effects on individuals, businesses and financial institutions threaten the stability of regional economies and, by extension, the region, which, according to the World Bank, has been the most severely affected region globally.

9. It is believed that the incidence of de-risking of Caribbean banks peaked around 2016. The region's banks and governments have lobbied vehemently against this practice with correspondent banks, regulators, legislators and multilateral agencies. This heightened advocacy has contributed to some abatement, but regional countries still face periodic instances of de-risking by correspondent banks. Using data from SWIFT, the BIS estimates that the Caribbean lost more than 40% of relationships between 2011-2020.

10. Much has been written on the causes and effects of de-risking[1] on developing countries but durable solutions are still lacking. The loss of CBRs is akin to denying a country access to the SWIFT payments platform, an action that is only contemplated in extreme circumstances.

<u>De-risking and its Causes in the Caribbean</u>

11. The Financial Action Task Force defines de-risking as

> "situations where financial institutions terminate or limit business relationships with entire countries or classes of customers in order to avoid, rather than manage, risks in line with the FATF's risk-based approach (RBA)."[2]

12. De-risking can take several forms, including the refusal to open accounts for certain clients, withdrawal or restrictions on some services or the complete termination of the correspondent banking relationship.

13. Caribbean countries have faced the threat of de-risking, from as early as 2012, when Jamaican banks were advised that money service business would be de-risked.[3]

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[1] For example,

1. International Monetary Fund (2017), "Recent Trends in Correspondent Banking Relationships: Further Considerations;
2. IFC Insights (2017), "De-Risking and Other Challenges in the Emerging Market Financial Sector: Findings from IFC's Survey on Correspondent Banking;"
3. World Bank (2018), "The Decline in Access to Correspondent Banking Services in Emerging Markets: Trends, Impacts and Solutions";

[2] FATF (2016) Guidance Correspondent Banking Services

[3] CARICOM Central Bank Governors Technical Working Group (2016) "De-risking and its Impact: The Caribbean Perspective" Caribbean Centre for Money and Finance Working Paper 01/2016

14. A 2016 survey by the Caribbean Association of Banks[4] found that 55 percent of banking respondents had lost at least one CBR. The services that were significantly affected included wire transfers, cheque clearing and cash letter deposits.

15. The Caribbean Financial Action Task Force,[5] in a broader 2019 survey of regional financial institutions, found that 30 percent of surveyed institutions had experienced restrictions or terminations of their CBRs over the three preceding years.

16. A recent unpublished survey indicates that financial institutions have taken steps to enhance their capacity to identify and manage risks while improving communication with correspondent banks. However, countries continue to experience a net loss in correspondent banking relationships, heightened counterparty risk and increased fees.

17. The persistence of de-risking has been attributed to several factors, including

    a. Low volumes of transactions and small profit margins;
    b. Increased compliance costs associated with regulatory requirements;
    c. Concerns about the quality of AML management by respondent banks;
    d. Perceived risk about the jurisdiction;
    e. Crack down on tax havens and offshore centres;
    f. Changes in banks' financial risk appetite; and
    g. Concerns about reputational risk.

18. An underlying cause of the strategy to de-risk, however, relates to the enhanced enforcement of AML/CFT regulations, especially in the United States and the European Union.[6] The threat of the imposition of substantial financial penalties by supervisory and law enforcement authorities for AML/CFT infractions has influenced correspondent banks to focus on larger banks and away from jurisdictions where it is perceived that there is heightened risk of non-compliance with international standards.

19. Correspondent banks carry out their assessments of jurisdictions, using public information, including the US State Department International Narcotics Control Strategy Report (INCSR). The INCSR is particularly problematic as it relates to the negative/high risk perception of Caribbean countries. While the annual INCSR clearly states that it is not a listing or rating of any kind, the stature of the US State Department and the potential for this report to influence the actions of US financial institutions is irrefutable.

[4] Caribbean Association of Banks (2016) Summary of Findings: Correspondent Banking Survey
[5] Caribbean Financial Action Task Force (2019), 'De-risking' in the Caribbean Region – A CFATF Perspective";
[6] Rice, Tara, Goetz von Peter and Codruta Boar (2020): "On the global retreat of correspondent banks" BIS Quarterly Review, March.

20. Of equal concern is that the information presented does not always completely or accurately represent a country's profile. In addition, the report is produced annually which may result in a significant lag between when countries make improvements to their AML/CFT framework and when these improvements are communicated via the report.

21. CBRs have been threatened by an overzealous interpretation and enforcement of rules aimed at preventing money laundering and starving terrorists of funds. The USA PATRIOT Act (2001):

    a. Imposes due diligence and enhanced due diligence (EDD) requirements on US financial institutions which maintain foreign correspondent accounts;
    b. Prevents foreign shell banks from having access to the US financial system; and
    c. Authorises federal law enforcement to investigate any foreign bank maintaining a US correspondent account.

22. On January 1, 2020, the U.S. Congress enacted the Anti-Money Laundering Act of 2020 (AMLA), which represents one of the most significant changes to the anti-money laundering laws of the US since the USA PATRIOT ACT. Major challenges related to correspondent banking include the following:

    a. In Section 6308, AMLA expands the authority of the Treasury Department and the Department of Justice (DOJ) to seek and obtain banking records located abroad;
    b. AMLA limits the ability of foreign banks to argue that the production of those documents would violate local banking laws and regulations; and
    c. The Act requires U.S. institutions to "monitor the foreign bank's compliance with a subpoena and forces U.S. banks to get involved in foreign bank compliance".

23. This Act expands the authority of Treasury and the DOJ to seek any records relating to the correspondent account "or any account at the foreign bank," including records maintained outside the United States so long as they are subject to several enumerated categories, specifically, any investigation of a violation of United States criminal law, any investigation of an AML violation, a civil forfeiture action, or an investigation pursuant to the USA PATRIOT ACT. This greatly expands the DOJ's reach into foreign bank records and creates additional obligations for US financial institutions to keep records and monitor the foreign banks' compliance when subpoenas are served. Financial institutions in the United States may be subject to fines or penalties if the foreign bank does not comply with the subpoena, with no specific definition of what constitutes "compliance." In this sense, the US financial institution may be obligated to terminate the correspondent relationship with the foreign bank or be subjected to fines of up to $25,000 per day. This puts institutions in a position where they must monitor the foreign bank's compliance with a subpoena and forces banks in the United States to get involved in foreign bank compliance.

24. Given the unintended de-risking consequences of the application of its standards, the FATF has issued clarifying guidance about the risk-based approach (RBA) and the need for case by case rather than wholesale de-risking. It is generally accepted that rules-based regulations frustrate financial inclusion and proportionality, which is core to the RBA.

25. Over the years, several Caribbean jurisdictions have been placed on enhanced monitoring by the FATF (FATF grey list). Those countries placed on the list in the 4th round of assessments included: The Bahamas, Barbados, Cayman Islands, Jamaica, and Trinidad and Tobago. Others escaped by virtue of the size of their money supply (M3[7]) e.g. Antigua & Barbuda, St. Kitts and Nevis, St. Lucia and Turks and Caicos, which are all under the enhanced monitoring of the CFATF. However, the FATF can, at any time, bring these countries into their active pool. To date, no Caribbean countries have gone through the 4th round Mutual Evaluation process without landing in enhanced follow-up. This is in spite of the significant time and resources spent on AML/CFT programs.

26. These countries are actively working with the FATF to address deficiencies in their regimes to counter money laundering, terrorist financing, and proliferation financing and the countries have committed to resolve the identified deficiencies within agreed timeframes. Such deficiencies must be seen in the context of a complex methodology that seeks to measure the effectiveness of a country's AML/CFT framework. However, the listed countries do not feature in international ML/FT crimes with proven criminal cases as is observed in developed countries. The use of M3, as the FATF's measurement of having a significant impact on the global financial system, is frustrating given that, in reality, risk and context, countries in the region are not major financial centres.

27. It is therefore concerning that despite the commitments from these countries and the work actively done to address the deficiencies, the impact of this grey listing is effectively punitive and contributes to the de-risking experienced by Caribbean countries. Correspondent banks continue to apply counter measures rather than enhanced due diligence which is an inaccurate application of a risk-based approach.

28. Further compounding the impact of the FATF grey list, in May 2020, the European Commission blacklisted The Bahamas, Barbados, Jamaica, and Trinidad and Tobago. In spite of the statement of commitment and recognition of the countries to actively address the issues with the standard setting body, the Commission opined that the countries had failed to properly address the threats of money laundering and terrorism financing. Further, the anomaly with Trinidad and Tobago is that they were removed from the FATF list but remain on the EU list. Such mixed messaging and lack of transparency fuels misunderstandings of risk and de-risking.

[7] M3 is a broad measure of the money supply that includes M2 as well as large time deposits, institutional money market funds, short-term repurchase agreements (repo), and larger liquid assets.

29. Added to the fallout from AML/CFT compliance restrictions, several Caribbean countries have been placed on the grey and black lists of EU non-cooperative tax jurisdictions.

30. These listings have resulted in the Caribbean, as a region, being painted as a tax haven. Despite recognising the significant resources and commitments to international standards, there appears to be an uphill battle with constantly moving targets.

31. The Caribbean typically represents a small portion of a correspondent bank's business. The added perception that the region is high risk has led to the costs/risks being deemed as outweighing the benefits. Hence, respondent banks, in jurisdictions with good AML/CFT assessments or with low incidents of involvement in major cases like those featured in the developed countries, may still be de-risked.

32. The perception and narrative that the Caribbean is a high-risk region needs to change. For example, there is criticism that Ugland House in the Cayman Islands houses over 12,000 companies. The impression given is that this could be a tax scam without acknowledging that in the state of Delaware, there is a similar building that houses over 300,000 companies, including some of the largest companies in the world. American Airlines, Apple, eBay, Verizon, and Walmart, are registered there, as are more than half of the companies on the Fortune 500.

33. The United States has been ranked at #1 on the Financial Secrecy Index[8] which seeks to measure which jurisdictions contribute most to enabling individuals to hiding their finances from the rule of law. The impact of this ranking contrasts with the impact of listings levied on small jurisdictions such as those in the Caribbean. It often seems as if there is no pressure on large economies, like the United States, to meet some of the standards that apply to small countries. Recent initiatives to build an effective beneficial ownership framework in the United States represents an important step in the right direction of narrowing the disparity in the application of standards in large and small states.

Impact of De-risking

34. The Atlantic Council's Financial Inclusion Task Force[9] noted that over the past decade, many financial institutions that previously provided international correspondent banking services have reduced the number and volume of related transactions and relationships. Using data captured by BIS, SWIFT BI Watch, and the National Bank of Belgium, **Appendix 1** illustrates that Caribbean jurisdictions have witnessed a decline in correspondent bank relations counterparties from 2011–2020. Other crucial measures of correspondent banking, particularly transaction volumes and values, depict that as a result of the decline in CBRs, transaction volumes in some countries have also decreased.

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[8] Tax Justice Network (2022), Financial Secrecy Index.
[9] Atlantic Council Financial Inclusion Task Force (2022), "Financial De-risking in the Caribbean: The US Implications and What Needs to be Done".

35. The Caribbean Financial Action Task Force (CFATF) notes that the most severe effect of de-risking in the Caribbean has been the termination of correspondent banking relationships which includes cheque clearing and settlement, cash management services, international wire transfers, trade finance and conducting foreign currency denominated capital or current account transactions. The financial institutions, agencies and other entities affected by de-risking include money transfer operators and other remittance companies, small and medium domestic banks, small and medium exporters, retail customers, international business companies and participants in e-gaming/gambling.[10]

36. De-risking generally may result in:

   a. Increased concentration, as fewer correspondent banks are handling payments;
   b. Driving payments underground due to unavailability or high transaction costs;
   c. Loss of access to banking services for some sectors such as remittance service providers and non-profit organisations;
   d. Products and services such as international wire transfers, cash management services and trade finance becoming difficult to access, which could result in increased cost for all classes of customers;
   e. Increases in the average processing time;
   f. Financial exclusion and may hamper efforts of governments and the business sector to provide essential services to those in need;
   g. Destabilization of the financial system; and
   h. Impediments to international trade.

37. For individual banks, the prospect of being de-risked presents a number of challenges. While some banks may be able to find alternative banking partners, others may find themselves cut off entirely. Moreover, securing new relationships takes time and money, and banks may find that any new arrangements are based on less favourable terms and conditions.

38. One implication has been for compliance costs to rise, but there is a view that the cost of compliance with the regulations may exacerbate conditions of poverty and fuel the said crimes that the rules were designed to prevent.

39. Banking customers may also be adversely affected as a result of de-risking. Without access to correspondent banking services, businesses and individuals may be unable to import goods from overseas. This inability to pay for cross-border goods and services could push some businesses into distress and lead to greater levels of unemployment. In some cases, consumers may be unable to send remittances to family members overseas.

[10] Caribbean Financial Action Task Force (2019), op cit.,

40. Some Caribbean nations continue to experience losses of correspondent banks in recent times. Some banks have had difficulty in securing new correspondent banking relationships with the major US correspondent banks due to the high-risk rating/perception of the Caribbean, and relatively low volume of transactions. This may impact the bank's ability to offer basic services such as wire transfer and credit card settlement. Some banks have been forced to rely on only one correspondent banking relationship.

41. Some Caribbean banks have also experienced restrictions on transactions. In some jurisdictions, the correspondent banks do not process certain transfers even if these transfers are within the boundaries of the respondent bank's own risk appetite. Some correspondent banks do not process transfers regarding precious metals because of the risk rating of the region, country, etc. while the transfers of this sector are within the bank's own risk appetite. In other Caribbean countries, limitations have been placed on services offered by correspondent banks, including limits on cheque clearing and international wire transfers.

42. Money services businesses in the Caribbean are often impacted as some local banks do not service these types of businesses due to limited risk appetite of the correspondent banks. Some correspondent banks do not process transactions of Money Service Businesses (remittance) and, as a result, remittances in USD cannot be processed.

43. Caribbean commercial banks have highlighted the challenges involved in maintaining their relationships and the need to respond to multiple and ongoing queries and questionnaires from their correspondents. They have identified that the questionnaires have become very detailed and require in-depth information on the licensee, its management, the bank's processes and products, and the bank's customer type. As a result, significant resources are expended to manage the correspondent banking relationships. For example, in addition to compliance units which ensure that the bank is compliant with AML/CFT/PF, the banks have also established units to manage the correspondent banking relationship.

44. Reduced access to traditional banking channels may lead to the use of informal money services or physical transportation of cash across borders. However, these unregulated channels may bring additional risks and leave people more vulnerable to criminal activity. A shift away from traditional channels could even create additional opportunities for money laundering and terrorist financing activities to thrive. Indeed, the CFATF has noted that when de-risking occurs, it drives financial transactions underground to less regulated or unregulated channels. It creates financial exclusion and there is reduced transparency. These all lead to increased risk of AML/CFT.

45. The situations where there has been a reduction in CBRs but increased transaction volumes or values suggest that there is a greater concentration of risk for the remaining CBRs within the region. Overall, the analysis shows that there has been a trend towards concentration in correspondent banking activity as measured by payment volumes. As such, should one of these major remaining correspondent banks decide to de-risk, this could have major implications for the Caribbean.

46. In an attempt to address problems stemming from de-risking, the Office of the Comptroller of the Currency (OCC) issued guidance in 2016 to banks regarding the withdrawal of correspondent banking relationships. It advised banks to conduct periodic risk re-evaluations of foreign correspondent accounts and to consider any information provided by foreign financial institutions that might mitigate risk, and provide institutions with

> "sufficient time to establish alternative banking relationships before terminating accounts, unless doing so would be contrary to law, or pose an additional risk to the bank or national security, or reveal law enforcement activity."

47. That guidance does not relieve banks of their AML requirements. It notes that the OCC does not encourage banks to terminate entire categories of customer accounts "without considering the risks presented by an individual customer or the bank's ability to manage the risk." It is unclear, however, what impact, if any, the OCC's guidance has had on banks' practices. When we consider that at the 3rd Caribbean Roundtable on Regional Solutions to CBR Withdrawal held in October 2018, in Nassau, The Bahamas, it was reported that one respondent bank indicated that it had sought out a Florida community bank to provide CBR services and the OCC questioned the community bank's strategy which implies a need to get the US regulators to the table.

48. De-risking in the Caribbean has security implications for the United States. Greater challenges to sending and receiving money through legal means increase the likelihood that banks and other financial actors will look for alternative avenues. This is referred to as "shadow banking", which are networks often used to hide criminal and terrorist activities. Use of these networks will make them more robust and stronger—and, thus, harder to bring down.

49. Caribbean economic instability caused by de-risking has indirect US consequences as well. The loss of remittances and trade limitations can push persons below the poverty line. This may leave these persons vulnerable to criminal activity and result in the human, drug and arms trafficking to the US from the Caribbean. The poverty caused by de-risking in the Caribbean could also result in increased illegal migration to the US which could in turn lead to a worsening of socio-economic conditions in the US.

Way Forward

1. Regional countries are committed to addressing any deficiencies in their AML/CFT regimes. In considering the way forward to reduce both money laundering and unfair listings of countries that imperil financial inclusion and economic development, we ask Treasury to adhere more closely to the principle of risk sensitivity and not to participate in listings of countries where the lists pose a material risk to a country's development and where there is no evidence that the country poses a material risk to the global financial system. This will protect financial inclusion locally and internationally, guard the international network against underground alternatives, and toughen the fight against money laundering. It will turn the big guns away from countries where little money laundering occurs to those where much does.

2. There is also the need for International Narcotics Control Strategy Report (INCSR) to be amended to include a section that shows improvements to the listed nations' anti-money laundering regimes. The INCSR should stop labelling countries as major money laundering countries and, at a minimum, jurisdictions should be allowed to respond to the draft report, so they can identify any factual inaccuracies prior to publication. Consideration should also be given to allowing countries to provide updates which would be published as addenda to the report when countries effect changes to their AML frameworks instead of waiting for the release of the next report.

3. Further, the guidance given by the OCC should be included in the legislation requiring US correspondent banks to provide clear rationale and analysis for decisions to exit or restrict a correspondent banking relationship, including why managing the risk was not an option.

4. It is important that correspondent and respondent banks establish or maintain open channels of communication. A lack of awareness of country context is often a contributing factor to de-risking, and sharing mutual concerns is valuable intelligence for the correspondent bank industry. The US Department of Treasury, Caribbean governments, and international financial institutions should consider hosting an annual hybrid-banking forum that brings smaller jurisdictions and correspondent banks together to facilitate relationship building and strengthening.

5. Separately, Caribbean governments and central banks will explore mechanisms to pool international payments to make them more profitable for correspondent banks or support the establishment of a US regulated institution that specialises in correspondent banking for the Caribbean or small states more generally in the expectation that this expertise and narrow focus will lead to a better assessment of risk.

Appendix 1

Changes in Correspondent Banking Relationships 2011-2020 (Select Countries)			
	Cumulative transaction volume	Cumulative transaction value	CBR (counterparties abroad)
Antigua	16.7	5.7	-30.2
Aruba	37.0	12.5	-28.8
Bahamas	25.4	-27.8	-41.3
Barbados	13.4	-28.3	-33.0
Belize	-43.2	-56.2	-50.8
Bermuda	-6.8	-31.6	-68.4
Cayman Islands	48.9	-15.9	-24.7
Grenada	30.5	125.2	-33.3
Guyana	66.9	28.7	-20.5
Jamaica	91.9	20.7	-40.0
St Lucia	7.4	-1.7	-31.5
Trinidad and Tobago	46.0	22.9	-39.1

Source: based on data from BIS, SWIFT BI Watch, and the National Bank of Belgium.

"WHEN BANKS LEAVE: THE IMPACTS OF DE-RISKING ON THE CARIBBEAN AND STRATEGIES FOR ENSURING FINANCIAL ACCESS"

HEARING BEFORE THE
U.S. HOUSE FINANCIAL SERVICES COMMITTEE

SEPTEMBER 14, 2022

WAZIM MOWLA
ASSISTANT DIRECTOR, CARIBBEAN INITIATIVE,
ADRIENNE ARSHT LATIN AMERICA CENTER, ATLANTIC COUNCIL

Chairwoman Waters, Ranking Member McHenry, and distinguished members of Committee, it is my privilege to address you this morning on the impacts of de-risking in the Caribbean and strategies for ensuring financial access. Today, my testimony will focus on (1) why correspondent banking relations matters and how de-risking is an impediment to Caribbean economic development; (2) how de-risking affects U.S. national security and why it matters for U.S.-Caribbean relations; and (3) recommendations that can help address de-risking in the short- and long-term. Today's testimony draws on the recommendations of the Financial Inclusion Task Force, which was convened by the Caribbean Initiative at the Atlantic Council's Adrienne Arsht Latin America Center.

First, I congratulate the Committee for prioritizing the withdrawal of correspondent banking relations in the Caribbean. It was an honor to accompany Chairwoman Maxine Waters to Barbados in April 2022 to participate in the Financial Access Roundtable that was co-chaired by the Honourable Mia Mottley, Prime Minister of Barbados in which the issue of de-risking was raised. Given the impacts and challenges facing Caribbean economies, governments, and citizens, urgent action is needed to safeguard the future survival and prosperity of the region. In this vein, addressing de-risking is critical. At the same time, ensuring that the Caribbean remains connected to the global financial system via correspondent banking relations has direct and indirect benefits for U.S. interests and its national security.

Financial development and access are cornerstones of economic growth and development. Critically, correspondent banking and cross-border financial flows are essential for countries, financial institutions, individuals, and businesses to transact and effect payments. These payments are necessary for all countries, particularly for international and domestic trade, foreign investment, portfolio management, and other key cross-border transactions, such as remittances. Simply, correspondent banking is the medium used to access international currencies, including the U.S. dollar. Without access to the global financial system, U.S. interests are adversely affected, as it provides an opening for increased financial crimes, illicit flows, the usage of Chinese currencies, and limits U.S. economic influence abroad.

The need to address de-risking in the Caribbean has never been more urgent. The region's small and open economies are under threat. Over the past decade, natural disasters and extreme weather events have limited the economic potential in the Caribbean. Over the past two years, the COVID-19 pandemic has taken on this role. Russia's invasion of Ukraine and the resulting consequences, in the form of rising food and energy prices, has the potential to cripple Caribbean economies and disrupt the livelihoods of the region's citizens. Correspondent banking is at the core of helping

Caribbean countries rebuild after each economic shock. It allows for countries to access development finance from multilateral banks to invest in new, resilient infrastructure and is a medium that allows organizations deliver needed aid to citizens in need.

De-risking and its effect on Caribbean economies

While de-risking occurs globally, the Caribbean is disproportionately affected. A 2015 survey by the World Bank found that the Caribbean, due to its small size and limited financial markets appears to be the world's most severely affected region. In 2017, a survey from the Caribbean Association of Banks noted that up to twenty-one Caribbean countries lost at least one correspondent banking relationship. And in 2019, a Caribbean Financial Action Task Force survey showed that at least sixteen banks from The Bahamas, Belize, Jamaica, and members of the Organization of Eastern Caribbean States lost access as well.

De-risking in the Caribbean varies from country to country. Of the Caribbean Community (CARICOM) countries, Belize (-51%), Saint Vincent and the Grenadines (-45%), Dominica (-42%), and The Bahamas (-41%) fared the worst by sheer numbers of lost correspondent banking relation counterparties. Specifically, in Belize, over the course of one year, three domestic banks lost 90 percent of their correspondent banking relations. For these countries, the cost of doing business increased across the broader economy, especially for sectors – such as the tourism industry – that are reliant on executing U.S. dollar transactions. Further, since U.S. and European banks were primarily responsible for de-risking banks in Belize, domestic banks had to look elsewhere for correspondent banking relations, specifically turning to services in Turkey and Puerto Rico. One consequence is that this incurred longer processing times for transactions with some operators in key economic sectors unable to receive payments for almost four months.

Importantly, de-risking affects three main drivers of economic growth and recovery in the Caribbean – remittances, travel and tourism, and access to the global financial system. Remittance flows to the Caribbean are critical for supplementing incomes of working-class populations and accessing the U.S. dollar. For Jamaica, remittances contribute a fifth of the country's overall GDP and for other countries, they account for upwards of at least 5 percent. Correspondent banking relations allow remittance companies, such as money transfer operators, to move currency from one financial institution to another. In the case of the Caribbean, it helps convert the U.S. dollar to localized currencies. De-risking affects this sector by increasing the operational costs of sending and receiving remittances. This becomes a deterrent to send remittances to the region and can provide incentives for relatives to use other, informal means of transferring money abroad.

The tourism industry in the Caribbean is also affected by de-risking. According to the Inter-American Development Bank, ten of the top twenty tourism-dependent economies in the world are CARICOM members. The value of the tourism industry cannot be understated, nor can correspondent banking be for the functioning of the sector. Correspondent banking is essential for credit card settlements. The inability to process transactions via credit or debit cards due to lost banking relations or high costs in accessing to the U.S. dollar can deter tourists. It also means that local hoteliers and restaurants that service tourists are less likely to afford to import products purchased abroad, such as food, pillowcases, bedsheets, among others.

Most importantly, de-risking limits the ability of Caribbean governments, financial institutions, and businesses to access the global financial systems in terms of trade, investment, credit, and financial flows. Most of these economies also run large physical-trade deficits because of their dependence on imported goods, fuel, and food. The result is that these companies are net importers of capital, usually in the form of investment, credit, and remittances. Without correspondent banking, many of the transactions needed to secure these goods and services would not be possible. De-risking leads to high costs to sustain these transactions and can have adverse effects on market functioning. Simply, it would limit banking customers from sending and receiving payments or maintaining relations with foreign suppliers. This can lead to decreases in revenue for businesses, ultimately contributing to defaults on baking loans, which, in turn, weakens the domestic banking system.

Addressing de-risking is critical for U.S. national security and interests

While de-risking has severe impacts in the Caribbean, the United States, its national security, and interests are not spared. Because of the region's proximity to the U.S. shores and as a logistics hub for the movement of people and goods, what affects Caribbean countries often impacts the United States. There are four main areas where de-risking affects U.S. interests: (1) the U.S. government's ability to regulate monetary transactions; (2) the effectiveness of U.S. economic influence; (3) the role of the Chinese currency; and (4) the long-term potential rise of political instability and crime.

The U.S. dollar as the world's most used currency is critical to U.S. influence abroad. For Caribbean countries, it is central to the health and functioning of their economies. And the main mechanism for accessing the U.S. dollar, beyond receiving hard cash during tourist arrivals, are through correspondent banking. De-risking curtails this possibility, and with it, U.S. monetary and regulatory agencies' ability to monitor transaction activity. Therefore, de-risking is counterproductive to addressing concerns of money laundering in the region if organizations, enterprises, and individuals are forced to use alternative currencies or avenues – a process commonly referred to as shadow banking. These networks can hide criminal and terrorist activities, making it more difficult for U.S. investigative agencies to bring them down. This presents a clear national security risk for the United States due to the Caribbean's proximity to countries that house illicit actors, such as Venezuela and Cuba. Increased shadow banking via de-risking coupled with limited U.S. regulatory capability due to lost access to the U.S. dollar exposes the Caribbean to becoming a future hub for criminal financing.

Over a 20-year period (1999-2019), the U.S. dollar accounted for an estimated 96 percent of all trade in the Americas, making the currency critical to the U.S.-Caribbean economic relationship. Companies that are seeking to shorten supply chains and nearshore to the Caribbean are likely to face barriers if they cannot pay service and product suppliers in the region. For companies looking to invest in emerging industries, such as the oil and gas markets of Guyana, Trinidad and Tobago, and Suriname, correspondent banking will be vital to ensuring that the U.S. private sector is able to compete for and maintain existing contracts. There are also implications for trade relations. Most owners of micro, small, and medium-sized enterprises purchase goods and services from the United States, specifically Florida. As of 2020, the Caribbean accounts for nearly 40 percent of all of Florida's trade with Latin America and the Caribbean. An inability to export to the Caribbean can decrease the overall trade balance of the U.S.-Caribbean relationship, forcing countries in the region to source products elsewhere.

Continued de-risking and loss of access to the U.S. dollar presents an opportunity for Caribbean governments and financial institutions to seek new or strengthen existing relationships abroad, notably with China. While Caribbean governments and people rely on the U.S. dollar, it is not the only internationalized currency. The euro is an alternative, but Caribbean governments face similar de-risking challenges with banks in the European Union. The result is an opportunity for Chinese RMB and its banks to strengthen ties with the Caribbean. Currently, Chinese RMB is not internationally traded to the extent of the U.S. dollar or the euro, nor are Chinese banks as present as U.S. correspondent banks. Chinese RMB also accounts for just 2 percent of global reserves. However, RMB use is increasing globally. From 2009 to 2016, Chinese CBRs globally grew from sixty-five to 2,246. Despite its limited global influence, the RMB still has the potential to be used in smaller markets t, such as the Caribbean. De-risking from U.S. and European banks can push them in this direction. More banking relations offer China new avenues to engage with partners in developing regions that are currently struggling to attract or maintain CBRs, such as Caribbean countries.

The draw of new banks and RMB usage from China is likely to be attractive for most Caribbean countries and can influence Taiwan's allies in the region. At present, five of Taiwan's remaining fourteen allies are CARICOM members (Belize, Haiti, Saint Vincent and the Grenadines, Saint Lucia, and St Kitts and Nevis). Except for Haiti, these countries have each lost more than 30 percent of their correspondent banking counterparties since 2011, meaning lost access to the U.S. dollar and potential economic benefits from the United States. China provides an alternative to its allies in the region and if the severity and frequency of de-risking rises in the region, Taiwan's allies might look to switch diplomatic recognition. These countries, because of their small size, are pragmatic actors, who make decisions in the best interests of the needs of their citizens and their own objectives. Thus, if de-risking continues to threaten Caribbean economic development in Taiwan's allies, Chinese assistance can be a plug for the holes left by U.S. banks that have de-risked the region.

Since the availability of correspondent banking relations underpins economic growth, the loss of them can drive people into poverty and unemployment as well as limit governments' ability to respond to the needs of their citizens. This leads to security risks for the Caribbean and broadly for the United States. First, increased poverty and unemployment incentivizes citizens to engage in criminal activity to replace lost household incomes and sustain their livelihoods. Further, it can be a driver for people to join criminal organizations for similar reasons, thus increasing the power of organized crime relative to the state and its own police forces. Second, since de-risking adds another layer of constraint of the fiscal flexibility of Caribbean governments, social unrest and riots might ensue when leaders cannot immediately respond to citizen needs. The likelihood of this increases with frequent disasters and economic shocks – something that is a regular occurrence in the Caribbean.

Strategies to address de-risking that can strengthen U.S.-Caribbean relations

Never has there been more appetite between the United States and the Caribbean to expand cooperation and strengthen their partnership. This was seen at the Ninth Summit of the Americas, where the United States announced the U.S.-Caribbean Partnership to Address the Climate Crisis 2030, otherwise known as PACC 2030. Further, Vice President Harris, on several occasions, and President Joe Biden at the Summit, has carved out time to meet with Caribbean leaders and listen to their perspectives and viewpoints on matters of shared interests, such as food and energy security and access to development finance. In fact, the Congressional Delegation led by Chairwoman Waters to Barbados in April of this year and this hearing to address de-risking in the Caribbean are added indications that U.S.-Caribbean relations are headed in the right direction.

It is important now to take these words and turn them into legislative action. Addressing de-risking can be a first, tangible step as correspondent banking is the lifeblood of economic activity in the Caribbean. In many ways, it is one of the most important avenues of U.S.-Caribbean relations, enabling U.S. government agencies to provide disaster assistance after natural disasters, allowing the U.S. private sector to invest in the region, and ensuring the trade relations with Caribbean countries remain strong.

Earlier this year, the Caribbean Initiative at the Atlantic Council's Adrienne Arsht Latin America Center released a report, "Financial De-risking in the Caribbean: U.S. Implications and What Needs to be Done," of which the foreword was written by Chairwoman Waters. The report was a result of an almost year-long process, where the Initiative's Financial Inclusion Task Force – a group made up of bankers, regulators, and multilateral representatives from across the United States and the Caribbean – met to provide recommendations on how U.S. policymakers can best curb de-risking.

Based on the findings of the report, there are several actions U.S. legislators can take to support Caribbean economic development and protect U.S. interests by addressing de-risking. Since correspondent banking is integral to a functional and healthy global economy, this Committee should consider putting forward legislation that categorizes it as critical market infrastructure or a public good. Through the U.S. Congress, this determination would provide justification for the U.S. Government and international financial institutions to incorporate access to correspondent banking as part of aid and development packages.

Key to the process of addressing de-risking in the Caribbean is ensuring that the affected actors are part of the overall discussion. Caribbean financial institutions and governments have first-hand accounts of the unique challenges they face to address the causes of de-risking and are therefore in the best position to provide feedback on which strategies are most effective. This Committee should consider, through legislation, working with the U.S. Treasury to consult with affected Caribbean actors when developing solutions that lead to greater financial access for the region.

Working hand-in-hand with the Caribbean financial institutions and governments also means providing them with a platform that shows progress these actors have made to fulfill compliance and regulatory requirements. As such, the Committee should consider adopting and passing "The INCSR Improvement Act," which will help Caribbean financial actors and government leaders annually underscore actions taken to address money laundering, drug trafficking, and financial crimes. The passage of the Act will help promote healthy dialogue between U.S. and Caribbean actors.

Dialogue is critical to addressing de-risking. Therefore, the Atlantic Council is working alongside and in coordination with several key partners to create an annual U.S.-Caribbean Banking Forum. The intent for the Forum's creation stems from the Atlantic Council's report on financial de-risking and was supported by Caribbean government leaders and U.S. legislators during the April 2022 Financial Access Roundtable in Barbados. Since then, an organizing committee that comprises bankers, multilateral representatives from across the Americas, and the Atlantic Council has been formed to carry out the inaugural Forum and will look to include the recommendations and feedback from this hearing into its eventual agenda.

In sum, the health and future of U.S.-Caribbean relations may well depend on correspondent banking relations remaining present in the region. Caribbean countries face an uphill battle to address de-risking. Even some of their solutions to note such as launching a Central Bank Digital Currency (CBDC) to address de-risking comes with its challenges. An Atlantic Council tracker on CBDCs notes that cybersecurity is an increasing concern as well as the ability of countries to house these currencies where there is instability in the financial system – two areas where Caribbean countries are still in need of support.

Decisive action is needed for U.S. interests and national security, yes, but also for the prosperity and livelihoods of the average U.S. and Caribbean citizen. Thank you, once again, for the honor and the opportunity to appear before the Committee today. I look forward to answering your questions.

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HEARING BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

Testimony of Wayne Shah
Senior Vice President, Wells Fargo & Company
Vice Chair, Financial and International Business Association

September 14, 2022

Chairwoman Waters, Ranking Member McHenry, and Members of the Committee: Good morning. I am Wayne Shah, Senior Vice President of the Financial Institutions Group at Wells Fargo and Company[1] and a board member and on the Executive Committee of the Financial and International Business Association (FIBA), of which Wells Fargo is a longstanding member. I appreciate the opportunity to be here today and look forward to sharing with you the many ways in which Wells Fargo is working support our correspondent bank customers in the Caribbean and the communities they serve. I will speak to you today in two capacities: first, I will discuss Wells Fargo's activity in the Caribbean, and second, I will discuss FIBA's efforts in this area.

Wells Fargo and the Caribbean

At Wells Fargo, we provide a diversified set of banking, investment, and mortgage products and services, as well as consumer and commercial finance, through our four reportable operating segments: Consumer Banking and Lending, Commercial Banking, Corporate and Investment Banking, and Wealth & Investment Management. I work for Wells Fargo Corporate & Investment Banking[2] and support both domestic and

[1] Wells Fargo (NYSE: WFC) is a leading financial services company that has approximately $1.9 trillion in assets. It proudly serves one in three U.S. households and more than 10% of small businesses in the U.S., and is a leading middle-market banking provider in the U.S. In the communities we serve, the company focuses its social impact on building a sustainable, inclusive future for all by supporting housing affordability, small business growth, financial health, and a low-carbon economy.
[2] Wells Fargo Corporate & Investment Banking (CIB) is a division within Wells Fargo & Company. CIB delivers a suite of capital markets, banking and financial products and services to corporate, commercial real estate, government and institutional clients globally. Products and services include corporate banking, investment banking, treasury management, commercial real estate lending and servicing, equity and fixed

international financial institutions through a dedicated industry coverage team. We are a major correspondent bank to other banks and our commitment to serving financial institutions spans Wells Fargo's 170-year history and continues to this day.

Wells Fargo has provided strategic correspondent banking services to Caribbean banks for more than 50 years. Our commitment to the region's growth and development is underscored by our market share and the number of countries where Wells Fargo's services are available. Wells Fargo correspondent banking provides services to financial institutions at the regional, head office, and individual country level, which all facilitate financial access. Today, we provide services to over 30 countries in the Caribbean.

Following the 2008 financial crisis, the process known as "de-risking" accelerated in the Caribbean. "De-risking" refers to "the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage risk."[3] In 2007, with the support of Wells Fargo, FIBA created the Caribbean Roundtable to highlight and discuss pressing matters for the Caribbean banking community. FIBA leveraged the Caribbean Roundtable to investigate the potential loss of support for correspondent banking in the Caribbean region, which FIBA ultimately attributed to the change in perception of the risk the Caribbean region posed.

According to FIBA, de-risking seemed to disproportionately impact smaller respondent banks in the smaller islands, who were no longer able to support their customers' international business via:

- Access to international markets.

income solutions, as well as sales, trading, and research capabilities. CIB is the trade name used for the corporate banking, capital markets, and investment banking services of Wells Fargo & Company and its subsidiaries, including but not limited to Wells Fargo Securities, LLC, member of NYSE, FINRA, NFA, and SIPC, Wells Fargo Prime Services, LLC, member of FINRA, NFA and SIPC, and Wells Fargo Bank, N.A., member NFA and swap dealer registered with the CFTC and security-based swap dealer registered with the SEC. Wells Fargo Securities, LLC and Wells Fargo Prime Services, LLC, are distinct entities from affiliated banks and thrifts.

[3] U.S. Department of State, https://www.state.gov/de-risking/.

- Foreign payments and trade services.
- Cross border credit cards.

During this time, other financial services necessary to support tourism, net foreign investments, international payments, and trade finance continued to be available through the larger, unaffected financial institutions.

Wells Fargo remained in the Caribbean region during this time period. We recognized, and continue to recognize, the risks posed by the correspondent banking business to Wells Fargo and the broader U.S. financial system. Our approach post-financial crisis has been to manage and mitigate those risks. Instead of completely exiting, Wells Fargo embarked on a significant effort with respondent banks to understand the risks posed by their customers and transactions, as well as how respondents mitigate those risks in their BSA/AML programs. Where appropriate, we provided thought leadership on how these programs could be strengthened. Wells Fargo's focus was to understand, improve, and align risk management objectives with our risk appetite. Our aim was to provide customers with the information, tools, and support to grow and improve with the benefit of our robust risk management standards.

To that end, Wells Fargo takes a leadership role in creating and participating in regional forums that discuss Caribbean financial issues. Wells Fargo established an internally funded annual Caribbean Conference, whose purpose is to create a forum for regional networking and collaboration and provide the opportunity for Wells Fargo to collectively work with Caribbean respondents navigating change, supporting risk appetite alignment, and offering thought leadership. The goal was to foster self-reliant and resilient financial institutions. The conference is focused on building a better and safer financially inclusive Caribbean ecosystem.

FIBA and the Caribbean

As a FIBA Board Member, I would like to also take a few minutes to talk about the contributions FIBA made in response to de-risking the Caribbean. Built on a legacy that spans over 40 years, FIBA is a non-profit trade association and international center for financial excellence whose membership includes the largest financial institutions from Europe, the United States, Latin America, and the Caribbean. As the leading voice for international banking in the U.S., Latin America, and the Caribbean, FIBA is recognized by the financial services industry, regulators, and law enforcement as a Center for Excellence for its knowledge and expertise in anti-money laundering compliance and its high-level education and training programs.

In 2009 at a Roundtable session, FIBA first raised concerns about the potential loss of support for correspondent banking in the Caribbean region. Over the next several years, FIBA focused on this issue, inviting stakeholders from Caribbean governmental agencies, Caribbean financial institutions, the U.S. Treasury Department, and U.S. regulatory agencies, to debate the causes and potential solutions.[4] According to FIBA, U.S. national security depends on prosperity and stability in the hemisphere. Establishing financial links to our neighbors strengthens the region, our alliances, and ultimately ourselves. Severing those links does the opposite. Healthy business relations facilitated by correspondent banking is an essential cog in that machine.

Over the years of de-risking, FIBA could not find any empirical evidence to believe that Caribbean banks had lesser abilities regarding BSA/AML. In fact, FIBA's view was that the Caribbean banks that remain in the market have invested heavily in BSA/AML compliance enhancements and risk management measures and are currently highly compliant with international guidelines and industry best practices.

[4] Attached is a FIBA presentation made to the Association of Supervisors of Banks of the Americas "De-Risking: How is it impacting correspondent banking in the region and what are the solutions?"

FIBA's Caribbean Roundtable was successful in identifying the cause and effect of early de-risking that served to alert members to the phenomenon at large. Discussions with all stakeholders over the years raised awareness and caused Caribbean banks to improve their BSA/AML compliance programs. FIBA was instrumental in providing much needed training courses, webinars, and leadership. As the organization identifying and responding to the phenomenon of de-risking, FIBA actively participated and was a key contributor to the efforts of a variety of organizations that also became active in the de-risking space. FIBA's contribution to the work surrounding de-risking is noted in the support of findings by the Inter-American Development Bank, Caribbean Association of Banks, International Monetary Fund and, most recently, the Bankers Association for Finance and Trade, and the Atlantic Council.[5]

In FIBA's opinion, the era of de-risking of small Caribbean banks has long been over, but major challenges remain for financial inclusion for the Caribbean, including:

- Making sure history does not repeat itself and de-risking does not affect the larger Caribbean banks.
- Encouraging correspondent banks to return to the region.
- Sustaining a view that the Caribbean is a region of safety and soundness for financial services and inclusion.
- Encouraging independent country and counterparty risk analysis.
- Calibrating regulatory mandates and addressing unintended consequences of legislation and regulations.

On behalf of Wells Fargo and FIBA, thank you for letting me speak today. I welcome your questions.

[5] https://www.atlanticcouncil.org/wp-content/uploads/2022/02/Financial-De-Risking-in-the-Caribbean_US-Implications.pdf.

FinClusive

U.S. House Committee On Financial Services

When Banks Leave: The Impacts of De-Risking on the Caribbean and Strategies for Ensuring Financial Access
Wednesday, September 14, 2022, 10:00 a.m.
2128 Rayburn House Office Building & WebEx

Amit Sharma
CEO & Founder, FinClusive

Introduction

Chairwoman Waters, Ranking Member McHenry, and distinguished members of the House Financial Services Committee, I am honored by your invitation to testify before you today.

I am particularly grateful for the opportunity to offer counsel on issues related to de-risking in the Caribbean and to discuss its widespread impact to national and economic security in the region and beyond given the deleterious impacts of financial exclusion, and attendant consequences related to financial system integrity.

Further, I look forward to sharing my views with the Committee on the value of new technology capabilities and innovation taking place both inside and outside the traditionally regulated financial services industry, and in particular in the leveraging of blockchain technology applications and virtual assets that can play an important role in addressing de-risking and drive equitable and safe financial services access—especially to particularly vulnerable groups and in need of secure financial tools and services.

Overview

Several important trends are important to recognize as we look at the evolution of financial services and the manner and methodology employed by many individuals and entities to financially and commercially transact between each other.

The first is the recognition that there has been, and continues to be, an exponential increase in financial intermediation taking place outside traditionally covered or regulated channels. These include, but are not limited to, peer to peer (p2p) transactions, the extension of credit and provision of lending by institutions (or individuals) to other institutions and individuals directly and without regulated intermediaries, the growth in mobile and web-based banking and financial services, the increasing 'digitization' and 'tokenization' of financial instruments and assets (e.g. cash, stored value, marketable securities, etc.) and the growing 'virtual asset services' sector. Under any rubric, we are seeing financial innovation blossom. Some of these efforts hold tremendous promise, while others may present addressable risks, and still others, unfortunately, look to deliberately circumvent or avoid the basic fundamentals of prudent financial intermediation.

Secondly, the growth of financial activities *outside* of traditionally regulated channels particularly noteworthy and provides tremendous opportunity to increase access for the globally underserved, unbanked, underbanked and those otherwise financially excluded, including those we would consider simply 'poorly' banked. Such efforts have understandably given financial regulatory agencies pause as nonbank financial services providers and other non-traditional finance companies have emerged into the formal financial services sector. Technology and social media companies, online/e-commerce retailers, marketplaces and crowdfunding platforms, corporate entities with large recurrent user/consumer populations, and others with large and growing affinity groups are increasingly realizing the commercial potential of providing financial products and services through their infrastructure and existing networks. While these efforts provide great promise in reaching traditionally underserved/excluded populations, doing so without essential safeguards to safety, soundness, consumer protection and financial system integrity could indeed lead to broader and systemic risks or the facilitation of illicit activities to which the BSA and other US regulations governing AML/CFT are intended to address.

Finally, since the tragic events of September 11, 2001, and exacerbated by the credit and financial crisis of 2008, a growing body of regulations and financial oversight rules have understandably caused consternation among financial market participants – traditional and non-traditional alike – working to adhere to these guidelines. With an average governance/risk/compliance (GRC) spending of greater than 25% of their operating budgets on regulatory costs, global banks have faced the 'economic' reality of servicing otherwise labelled "high perceived compliance risk" individuals and entities or suffering the consequences of regulatory fines and punitive measures for lack of demonstrably strong AML/CFT controls. Further, new entrants to the financial sector face consequential costs in their efforts to ensure their risk and compliance controls, policies and procedures, personnel, and relevant regulators and supervisors—in some cases numbering greater than 50 in the nonbank money services business sector—are appropriately engaged and in place to undertake activities that would serve broader financial inclusion initiatives, but nonetheless face both a diverse and less-than-clear regulatory landscape, as well as a lengthy and costly approval process to undertake their activities.

By no means do I sympathize with those institutions that have willfully chosen to turn a blind eye to money laundering, sanctions evasion, terrorist financing and other illicit activity, or underinvested on foundational AML/CFT controls. However, we are indeed seeing the consequence of growing regulation and the associated economic consequences stemming from "de-risking" or the jettisoning of business otherwise considered "high perceived compliance risk." Such efforts have unfortunately fallen disproportionately on those constituents–individuals and entities—whose financial engagement and access is essential to building economic resilience, and sustainable financially responsible behaviors—the US and global poor, international remittances, humanitarian assistance and charitable works, and international correspondent banking, among others—all examples of de-risking and a lack of inclusive financial opportunities in the Caribbean and indeed in many other parts of the world.

Indeed, even in the face of specific national security threats and challenges the US Government and its allies across the world face, the use and propagation of alternative financial service applications including virtual assets, blockchain enabled value transfer systems, decentralized financial services protocols are showing to be a rapidly growing and useful set of solutions. Where many traditionally financially marginalized populations are unable to engage with formally regulated banks, web-based applications that enable individuals, households, small businesses and even whole governments (e.g. Ukraine), are able to raise money and transact digitally -- providing a viable and scalable alternative when formal channels for financial access are no longer available. The good news is that the technological and operational infrastructure enabling such access carry with them the very attributes that enable consumer protection, traceability of transactions, verification of identity, and ultimately to build and extend economic resilience.

The manner in which financial exclusion has grown in the Caribbean and the attendant risks of 'de-risking' due to ongoing AML/CFT uncertainty amidst a growing trend of nontraditional and technology-led initiatives to provide financial services, behooves us to look at this obstacle in a fundamentally new light and to find ways in which new technology can in fact drive financial inclusion and provide secure and equitable gateways to essential financial services, while they strengthen financial sector integrity in tandem.

The Importance of Financial Inclusion

It is important to reinforce the critical issue of financial inclusion, as access to financial services is vital to building economic resilience and strengthening overall financial health. The financially excluded or underserved stretches beyond the world's unbanked or underbanked individuals. Millions of small businesses, entrepreneurs, and organizations considered or labeled 'high compliance risk' by governments and global AML/CFT standards can also cause financial institutions to 'de-risk,' or deny or cease servicing such customers. Unfortunately, de-risking has also disproportionately impacted certain segments of the global economy where secure access to services is the lifeblood for many. De-risking is particularly problematic for:

- Certain types of customers: LMI (low to moderate income) and those without verifiable identification, the global poor, or those without a discernable or recorded financial or credit history;
- Certain types of businesses considered 'high perceived compliance risk,' which include: money services businesses (MSBs), money transfer operators (MTOs) and other remittance providers; nonprofit institutions and NGOs/IGOs, especially those working to deliver aid and assistance to areas of distress or conflict; international correspondent banks (especially those in emerging markets);
    - Importantly, the growth of fintech and virtual asset services providers, or VASPs, are now in the crosshairs of financial regulators, as these emerging and rapidly growing financial market participants and technologies engaged in alternative financial services are increasingly engaged in activities historically driven by mainstream bank financial institutions; they also provide valuable avenues for financial inclusion, and are powered by technology stacks that

actually serve to mitigate certain risks and present more efficient and transparent operations that can serve to strengthen intended AML/FCC controls; and

- Certain types of jurisdictions: emerging or frontier markets and/or those considered to have weaker AML/CFT regimes, financial system regulatory oversight controls, or otherwise challenged with systemic corruption.

These institutions, individuals and jurisdictions struggle to access formal banking relationships to simply hold and transfer value—the basic fundamentals of banking. These fundamentals enable individuals (and organizations) to improve their financial lives as they are related to the ability to spend, save, borrow, transact in society, and financially plan one's life. Financial inclusion activities enable as many people and organizations to engage in the formal economy, and must be facilitated with a confidence that their financial assets will be safe from theft, accessible to them when, where and in a manner they need, and transferable to those with whom they must personally and commercially interact.

Financial inclusion also pays dividends to the excluded and underserved as well as society as a whole. Simply including the unbanked in the formal financial sector can significantly help the global economy by reducing transactions in the black or unregulated markets and expose exploitative behavior and labor practices. With a growing reliance on remittances from more developed economies such as the U.S and Western Europe, many frontier markets receive upwards of 1/3 of their GDP from such flows. In fact, remittances make up more than three times the size of international development assistance (IDA).[1] Some estimates show that banking the unbanked would lead to a $600 billion rise in the worldwide economy per year, generate $4.2 trillion in new deposits, create 95 million new jobs and drive an estimated $3.7 trillion in global GDP growth.[2]

Financial inclusion is also a critical first step to building financial health. This is a common goal for populations in developed and developing economies alike. Too often, financial exclusion is (mis)understood to only impact the global poor in developing and frontier economies, but the challenges of financial exclusion impact even those in the U.S., one of the wealthiest nations on the planet. Statistics in the U.S. itself serve to illustrate this point:

- Approximately 25% of the U.S. are un- or under-banked—lacking secure and sustainable access to mainstream financial services;
    - Similar to global statistics, these numbers reflect individual financial exclusion and do not include the thousands of businesses (especially small and medium enterprises (SMEs) that represent 99% of all U.S. businesses) and entrepreneurs that lack access to credit and lending products to establish and grow their operations;
- Almost 2/3 of U.S. persons cannot handle an unintended expense of $400 or more;

[1] Migration and Remittances (worldbank.org); https://www.worldbank.org/en/topic/labormarkets/brief/migration-and-remittances
[2] https://www.mckinsey.com/~/media/McKinsey/Featured%20Insights/Employment%20and%20Growth/How%20digital%20finance%20could%20boost%20growth%20in%20emerging%20economies/MGI-Digital-Finance-For-All-Executive-summary-September-2016.pdf

- These include resulting out-of-pocket expenses such as an unexpected health event, a breakdown of a vehicle needed to commute to work or a house maintenance expense, which dries up minimal savings;
- Greater than 50% of the U.S. struggle with daily and weekly expense management;
    - The single most important driver of financial health is the ability to responsibly financially plan for one's future.

Beyond individual statistics, the impacts of financial exclusion in the small business community, including organizations considered to be small and medium enterprise (SMEs) is larger than many think. Formal SMEs represent approximately 90% of global businesses (note that 99% of all US companies are small businesses[3]), and more than 50% of official employment. The reality of financial exclusion grows when one includes informal or micro-businesses as well; according to the International Finance Corporation (IFC), 65 million organizations (40% of such organizations) in developing countries fall $5.2 trillion short of their financing needs every year. In the emerging markets, SMEs are also responsible for 70% of new jobs, but these companies are less likely to be able to obtain formal bank lending or access basic credit facilities.[4] When the majority of entrepreneurial ventures are essentially one- or two-person/family-based endeavors, financial access is more practically determined by individual characteristics and background vs. the organization itself. Ensuring that individual financial access issues are enabled directly can contribute to one's ability to start and grow their own businesses, employ others and grow their individual, household and community wealth.

De-risking presents an unfriendly obstacle to individuals, organizations, and jurisdictions in need of institutional support as some of the most financially vulnerable but economically essential members of the global market. The financial exclusion afforded by the de-risking approach cripples commerce through the systemic denial of access to financial solutions that are indispensable to growth. The good news is that with the growing reach of mobile and web-based technology applications working to connect individuals, households and businesses in the global economy, the advancements in commerce and digital access continue to enable more connectivity—even in some of the world's frontier and remote marketplaces. Smartphone penetration and adoption rates continue to increase, which enables connectivity for financial services that are much more capable today than five or ten years ago.[5] While access challenges continue to be addressed as more connectivity is enabled, ensuring safe and equitable access to financial services—those that can be assured with data privacy and economic security controls remain an ever-growing need.

The institutional response should not be wholesale deregulation, but innovation in pursuit of the most efficient and developmentally stimulating allocation of resources that serve to broaden financial access while maintaining financial system integrity and consumer protections through a rapidly evolving financial technology and, in some cases, exclusively web-based environment.

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[3] https://www.sba.gov/sites/default/files/advocacy/2018-Small-Business-Profiles-US.pdf
[4] https://www.worldbank.org/en/topic/smefinance
[5] https://www.statista.com/statistics/203734/global-smartphone-penetration-per-capita-since-2005/

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<u>Modern Institutional Challenges Aggravated by De-risking</u>

In the current environment resulting from the COVID-19 pandemic, issues of financial exclusion and challenges related to a lack of access to financial services and the ability for organizations and individuals otherwise excluded by formal financial services have come in stark relief. As discussed previously, de-risking has disproportionately impacted certain segments of the economy with profound consequences to their ability to ensure their own financial stability and economic security. Tools enabled by blockchain technology in both regulatory compliance and cross-border payments play an essential role in addressing these challenges, which have manifested in many areas, specifically including:

- Ability for small businesses to engage financial services and support through the Paycheck Protection Program (PPP)–Banks need a streamlined and efficient process to take in, process and conduct due diligence on these organizations as well as ensure on an ongoing basis that such attributes that have supported their application remain in the months ahead when such programs are executed and funds are provided and accounted for by participating financial institutions.
- Financially excluded or underserved individuals and organizations like those noted above are often considered to be of 'higher perceived risk' by traditional financial institutions. Tracking their payments and ensuring auditability of client and transaction data becomes especially important; blockchain tools can play an important part as they can support digital identity applications to strengthen KYC/KYB requirements and transactions-based analytics.
- Ability for individuals to receive ongoing stimulus or economic support checks as part of federal and state-based programs, where they may not be in formal banking relationships, but do engage in alternative financial products including digital/virtual-asset related services.
- Ability for individuals and companies to facilitate cross-border remittances, which have been impacted by the pandemic. Analysis shows migrant workers were impacted as many were sending less money home (e.g. South Asia, Africa, Latin America) and are beginning to see more monies needed back in the US. This reversal of overall flows flexibly (through multiple channels, including digital/crypto) and securely will be a lifeline to families, households and businesses.
- Nonprofit and charitable organizations – including those engaged in COVID-19 response and relief efforts struggle to maintain financial services to include accounts (store of funds), operations (financial operations and treasury management), and payments (sending needed funds to beneficiaries in need in a timely and secure manner). Blockchain-enabled value transfer systems serve to connect counterparts globally and securely with near-real time payments capabilities and transparency/auditability of transactions to ensure funds are both sourced from legitimate parties and sent to/received by intended beneficiaries in need.

De-risking limits opportunities for financial inclusion in these areas, further disparaging underserved populations. For example, humanitarian organizations reported that they have lost

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access to financial services as a result of de-risking. This restricts humanitarian assistance to refugees from political conflicts or natural disasters that could prevent life-saving aid from reaching those experiencing starvation, exposure, and/or disease.

According to the FATF – "De-risking affects services and products, financial institutions and other agencies. The most severe effect of de-risking in the Caribbean has been the termination of correspondent banking relationships which includes check clearing and settlement, cash management services, international wire transfers, trade finance and conducting foreign currency denominated capital or current account transactions."[6] According to the Center for Statistics & International Studies, "a survey in 2017 by the Caribbean Association of Banks found that 21 of the 23 banks in 12 Caribbean countries had lost at least one correspondent banking relationship. The impact was particularly hard on countries in the Eastern Caribbean (in particular Antigua and Barbuda and St. Kitts-Nevis), Suriname, and Belize."[7]

De-risking increases costs, financial exclusion, and mistrust for the end user and drives financial transactions underground to unregulated channels. These channels do not necessarily follow best practices or abide by regulatory obligations introducing more anonymous banking and unmonitored or reported money laundering or terror financing activities. Ironically, achieving the polar opposite of de-risking aims. This pushes financial services from the regulated entities directly to the higher risk unregulated entities that can afford to provide unregulated financial services or hawalas.

The Council of Europe finds de-risking unacceptable within the framework of FATF standards in its termination of entire classes of customer relationships without thorough risk analysis. Such compartmentalization manifests itself in the unwarranted financial exclusion of individuals and organizations, notably NGOs.

The Value of Blockchain Technology in Financial Inclusion

There are several areas in the regulatory compliance and payment space that can be enhanced by the use of blockchain technology. The foundational attributes of this technology helps build and reinforce trust and provides transparency and security in ways that traditional bank and nonbank financial institutions can leverage to enhance both value transfer as well as financial crimes compliance (FCC) controls and activities.

Briefly, those attributes include:

- ***Immutability*** – participants in a network are unable to change or tamper with transaction or client data after it has been recorded to the shared ledger. This attribute has application in enhancing know your customer/know your business (KYC/KYB) verifications to manage ongoing customer information and attributes as well as transaction-level data

[6] De-Risking (cfatf-gafic.org)
[7] https://www.csis.org/analysis/there-new-normal-de-risking-caribbean

(payments and transfers of value) for appropriate transaction monitoring and associated risk scoring and analytics.

- ***Distributed/Decentralized*** – Governance is spread across participants in a particular network such that information/data (transactions, contracts, value, client information) can be accessed by participants in a network no matter where located, lessening concentration risks of control of important data, and providing transparency related to such data without having to uncover the particulars of the data (sensitive personal identifying information). This incentivized self-governance can be provided both through public blockchains as well as private or federated blockchains.
- ***Permissioned*** – Each member of the network must have access privileges and information is shared only on a need-to-know basis between network nodes. Information regarding the transaction origin (sender) and recipient can be permissioned between nodes for easy and secure access without disclosure to third parties without permission, and be leveraged for verification/validation purposes, managing against fraud, and assisting network participants in a common financial ecosystem.
- ***Security*** – the encrypted and distributed nature of blockchains alongside the immutability of the ledger, allows for the preservation of underlying data or assets being transacted to maintain security controls and needed protections. As information is hashed cryptographically on the blockchain, the true nature of the data (sensitive PII or transaction data) can be protected, but results, outcomes or other verifications of such data can still be provided—to regulators, counterparties, law enforcement or others.

One of the most visible and growth-oriented areas in the application of blockchain technology is in the increasing issuance and use of virtual assets, generating new ways of creating, storing, and transferring value over the internet. Virtual assets have the potential to enable the creation and movement of value between counterparties directly, and over an internet infrastructure that does not necessarily require intermediaries to do so. Stablecoins, including and in particular those collateralized, backed, pegged or represented by fiat currencies or other 'stable' assets represent an additional value of extending the reach of economic value to counterparties in need. These innovations serve to reinforce the additive nature of virtual assets to the formal financial services economy while reinforcing the power of capital and financial markets—such as the US in the case of US-dollar backed stablecoins—which form an additional extension of positive influence of the US to its global neighbors.

What has been the purview of a few large technology companies enabling access to such tools and services, can now increasingly be accessed, created, and maintained with open-source code and technology applications that reward these infrastructure providers, that tokenize value that is increasingly fungible and enabling of everyday commerce. These innovations represent the next frontier of web-based applications that can be truly peer-to-peer, and enable commerce across jurisdictions directly between counterparties and built on the attributes described above that serve to enhance system transparency and integrity, while enabling global access.

The aforementioned attributes, when applied in the case of underlying financial inclusion initiatives, can help make the world a more transparent, efficient, and frictionless place.

Importantly, blockchain enabled networks and digital assets have the ability to reduce some of the obstacles to providing efficient and affordable access to financial services to the millions of people in the United States and billions around the world that are underserved or excluded from the formal financial system. This is especially true given the growth in financial activities being undertaken by nonbank financial institutions. In, fact these non-bank nonfinancial institutions (e.g. charities and crowdfunding platforms, e-commerce companies, social media and technology companies) realize that their networks provide an easy-to-engage set of constituents to whom they can offer select financial services (storing and protection of funds, transfer of funds, access to funds, etc.) as long as those activities also ensure coverage of their FCC obligations to which 'covered' financial institutions are already subject.

Despite this potential, the widespread adoption of this technology by financial institutions, particularly to address the challenges of financial inclusion, remains slow due to the perceived associated risks and lack of clear and consistent regulatory guidance—reflecting both jurisdictional differences in approach and pace of adoption, and, as is the case in the United States regulatory environment, differences in approach by and between different functional regulators related to the institutions and activities they explicitly oversee. As a result, non-traditional entities and organizations less constrained by outdated regulations and technology have stepped into to make it easier, faster, and cheaper for people to fulfil their fundamental financial needs of creating, storing, and transferring value.

The decentralized and frictionless nature of virtual assets provides both an opportunity and a challenge to regulators and financial services providers alike. Financial regulators should embrace the myriad of opportunities this new technology is generating and tackling head-on the financial crimes risk associated with applications that leverage this technology through modernized FCC governance addressing one's *activities and practices* regardless of the type of entity or jurisdiction of domicile. Part of that effort should include a recognition of the attributes of blockchain technology that in fact make it easier in many ways to identify, track, and disrupt the illicit use of funds, while they also provide new mechanisms to provide banking and payments products in a new way—especially to financially underserved, excluded or marginalized populations and in furtherance of US national and international security and economic interests. Some notable examples of the use of virtual assets and capabilities afforded by blockchain technology include:

- Enabling marginalized communities (including those in areas of conflict or humanitarian strife) to be furnished digital wallets into which virtual assets—including USD-backed stablecoin—can be funded that enable access to vital economic resources and the ability to engage in peer-to-peer transactions between individuals and merchants providing essential services,
- Providing donors globally to provide needed funds quickly and directly to recipient organizations and individuals directly and without the complications associated with accessing cash or other fiat instruments,
- Ensuring know-your-customer (KYC) controls on digital wallets to remotely verify and validate individuals and businesses securely,

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- Incorporating essential transaction monitoring and analytics on transfers of digital assets between counterparties seamlessly and without compromise to personal data,
- Issuing digital identity credentials to users of wallets and virtual assets that can serve to verify those users, perform essential screens (e.g. sanctions checks), and trace transactions to ensure their legitimacy and security against exploitation by illicit actors.

There are several important innovations that serve to enable financial inclusive opportunities that also related to the requisite financial crimes compliance objectives the sector and regulators and policy makers would like to see to help protect consumer safety and privacy and overall financial system integrity.

Bringing Technology To Bear–Addressing Identity Challenges Amidst Increasing Globalization and Digitization of Financial Services

Identity has long played a central role in the financial services industry as access and financial system protections revolve around the central question of know-your-customer (KYC). KYC controls are based on the appropriate identity management and verification systems necessary for a financial institution's effective customer due diligence (CDD) and customer information program (CIP). Specifically, the focus of identification (establishment, authentication, and authorization) enables financial intermediaries (e.g. financial institutions, custodians or value transfer operators) to tie the property/assets (store of value) to be facilitated for a person associated with an established identity.

Identification is based on resolution of an identity, which assures the bona fides of a person using trusted, reliable sources of information to achieve confidence that not only the person exists, but that institutions are in fact also engaging (providing services to or interacting) with that specific person. The strength of the identification process directly contributes to the integrity of information which is relied upon to discern whether that specified person is connected to potential proceeds of crime and/or to untangle potential proceeds of crime from legitimate property.

As such, global guidance for KYC includes applications of both traditional identity management and verification activities and are increasingly incorporating more recent applications of digital identity systems, because the importance of identity management and verification is central to financial institutions' assurance that they are doing their part in keeping their institution—and the financial system more broadly—closed off from illicit actors. It is in this vein that global standard setters, such as the Financial Action Task Force (FATF), apply extensive guidance related to KYC to address anti-money laundering/counter-financing of terrorism (AML/CFT) and financial crimes compliance (FCC).

FATF has offered this specific guidance on digital identity: "using reliable, independent source documents, data or information…that provide an appropriate level of trustworthiness."[8] Through

[8] https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/Guidance-on-Digital-Identity.pdf

the review of how to assess the strength of identification, a risk-based approach can be used within digital identity tools to apply the right level of risk mitigation. This can be done by reaching out to newly available, trusted sources of identification (e.g., utilities, financial institutions, etc.) to meet the needs of the relationships that financial intermediaries have with clients and counterpart financial institutions. In fact, in light of the global COVID-19 pandemic over the last two years, FATF has further and explicitly noted that digital identity solutions and related technologies should be explored to aid and modernize financial services while managing illicit finance and security risks.[9] Dynamic expansion of the approach to such modernization is needed to address growing financial access concerns.

Globally, between 2.5 and 3.5 billion people are considered unbanked or underbanked. According to the World Bank, 1.7 billion adults (over 30% of the global population), are fully unbanked, which means that they do not have an account at a regulated financial institution or have funds/stores of value in an equivalent mobile money account.[10] This has a significant impact on their ability to maintain, let alone strengthen, their economic resilience.[11]

Unfortunately, the majority are disproportionately low or moderate income (LMI) or considered poor, exacerbating their inability to build financial wealth and improve their financial condition. Often it is the lack of a verifiable identity—understood most often as the proof of a government or federally issued identity—that prevents these individuals from being able to establish a bank account. The KYC and AML/CTF checks that banks are required to conduct before onboarding new customers pose a key hurdle to this verification.

As a result, for the more than 1 billion people that do not have a specific form of legal identification, financial access remains nearly impossible. Further, institutions are obligated to monitor their customers to ensure that their identity information (e.g. identification numbers, physical address, phone number, etc.) remains current. Failure to do so allows hackers, cyber criminals and other illicit actors to break into accounts and take over financial assets. This is particularly an issue in the United States (and many western countries) where overreliance on static personal identifying information (PII) exacerbates the identity management process in many financial institutions, resulting in the following problems:

- New account opening is difficult for many institutions, and losses from new account fraud have continued to remain high.[12]
- The U.S. Federal Reserve reports that synthetic identity fraud (fake names associated with real individual identity numbers such as personal passport, driver's license, or social security numbers) is costing U.S. lenders $6 billion annually and is the fastest growing type of financial crime in the U.S.[13]

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[9] http://www.fatf-gafi.org/publications/fatfgeneral/documents/statement-covid-19.html
[10] https://globalfindex.worldbank.org/
[11] Ibid
[12] https://www.javelinstrategy.com/coverage-area/2019-identity-fraud-study-fraudsters-seek-new-targets-and-victims-bear-brunt
[13] https://fedpaymentsimprovement.org/wp-content/uploads/frs-synthetic-identity-payments-fraud-white-paper-july-2019.pdf

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- Between 2017 and 2018, the volume of PII data exposed in data breaches increased by 126%, with more than 446 million records exposed.[14]

Also unfortunate is the global economic tendency to rely on paper-based identity proofs such as government-issued forms of identity. As financial services become increasingly digital, this "identity gap" between digital and physical identity documents continues to hamper access to digital payments and online financial services.[15] This is true for both developed and less developed economies. Digital identity solutions such as verifiable credentials technology can offer strong avenues of development to build more accessible and secure identification in order to bridge the gap.

Digitally Verifiable Credentials

Verifiable Credentials form the foundation for verifiable data in the web of trust. They can contain many different types of information as well as different types of credentials. Many software providers, private & public institutions, and a wide range of businesses are implementing this technology in their offerings.

Traditionally, regulated bank and nonbank Financial Institutions (FIs) run their own KYC, KYB and various levels of CDD and EDD for the subjects that would like to use their service offerings according to the risk profile of each subject. There is often hesitancy towards such reliance on 'third-party' KYC/KYB verifications, and thus there is no sharing or re-use of the corresponding results of the KYC/KYB and other screens associated with these clients between FIs. This ultimately serves to increase the cost and time to onboard a subject to the FI or revalidate subjects that may have already been screened and/or verified by previous KYC/KYB efforts and/or as part of the subjects' FI's customer information program (CIP).

To solve the sharing and reuse of compliance information without divulging the PII/EII, multiple efforts are underway in the marketplace to design digital identity issuance and validation protocols that 1) provide a verifiable proof of one's identity, and 2) enable control of underlying PII information by the user. Taken together, such verifiable credentials can be used to validate the authenticity of an individual (or a business), its level of risk as is necessary to be defined by regulated financial services companies on their customers and counterparties, and the explicit due diligence elements verified to comport to the level of that clients' risk.

FinClusive has developed and implemented a service called 'CDD Check Connect'. CDD Check Connect facilitates via a multilateral information sharing agreement between different partners and customers leveraging the FinClusive Compliance as a Service (CaaS) platform; thus enabling the FIs, whether or not they are customers of FinClusive, to share the compliance data securely and verify the credentials associated with subjects run through KYC/KYB.

[14] https://www.idtheftcenter.org/wp-content/uploads/2019/02/ITRC_2018-End-of-Year-Aftermath_FINAL_V2_combinedWEB.pdf
[15] https://morningconsult.com/opinions/the-future-of-identity-in-financial-services-threats-challenges-and-opportunities/

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Further, the level of due diligence as determined through the subjects' risk profile further delineates the risk associated with a client and can include levels and types of due diligence ranging from 'basic' (e.g. name match and sanctions screen) to 'enhanced' (e.g. social and adverse media, source of wealth, etc.). This multilateral agreement structure has been updated and refined to include standardized language of an AML compliance 'reliance agreement' which is constructed to enable the following:

- a third-party FI can 'rely' on the KYC/KYB/compliance processes of another FI (which would be FinClusive itself or another customer of FinClusive leveraging FinClusive's compliance applications and global KYC/KYB and CDD/EDD toolkit; and
- the ability to reinforce use and value of a common framework for FCC compliance and KYC/KYB processes both through its technology application as well as its governance and global AML/FCC policy formulation which comports to international standards.

The FinClusive CaaS platform embeds the decentralized identity/verifiable credential through the KYC/KYB processes, creating a unique identifier termed 'FinCID', which is connected to all of the subject's data stored in the platform. The subject's data includes both the attributes run through due diligence and background screening as well as evaluation based on their level of risk, as well as all of the transaction data generated by various platform services during the lifecycle of engagement with the subject. This includes transactional data associated with digital wallets belonging to or under the control of the subject. The FinCID is constructed such as to be able to be 'attached' to any 'client related attribute' from:

- the client's underlying personal identifying information/entity identifying information (PII/EII),
- the client's account details, digital wallet details, or other relevant account/transaction facilitation information,
- transaction data and flows, and
- affiliate data (counterparties with whom they transact, etc.)

Traditionally, regulated bank and nonbank Financial Institutions (FIs) run their own KYC and KYB and have various levels of customer due diligence (CDD) and enhanced due diligence (EDD) for the subjects that would like to use their service offerings based on their risk profiles. There is often hesitancy towards such reliance on 'third-party' KYC/KYB verifications, and thus no sharing or re-use of the corresponding results of the KYC/KYB and other screens associated with these clients between FIs, which serves to increase the cost and time to onboard a subject to the FI or revalidate subjects that may have already been screened and/or verified by previous KYC/KYB efforts and/or as part of the subjects' FI's customer information program (CIP). This is where the CDD Check Connect solution creates value; enabling the sharing and reuse of compliance information without divulging PII/EII.

Conclusion: Financial Inclusion as a Matter of National Security

I am hopeful these examples show how technological advancements in web-based infrastructure, tokenization of value, and digital identity—leveraging blockchain and distributed

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ledger technologies in particular—can serve to address ongoing de-risking challenges and strengthen and modernize AML/CFT efforts to drive financial inclusion.

In sum, we must look at the tools we have created to drive financial inclusion, community-based financial engagement, and risk-based approaches to financial facilitation that ultimately bring more activity to regulated financial channels. New technologies, including in advanced analytics, mobile and digital banking and distributed ledgers, can serve to provide additional financial engagement highways that are more easily accessible and afford the essential protections (in both privacy and personal data as well as personal financial assets) that remain inherent challenges to many financially underserved and excluded parties from securely engaging the financial system. These same technologies can serve to dramatically decrease the friction, redundancies and inefficiencies of the AML/CFT activity set while preserving the essential controls inherent in facilitating safe and secure financial intermediation.

The United States has one of the most effective AML/CFT regimes in the world. As we have relied more on this regime to address various threats to our national and collective security, our efforts are increasingly undercut by the misinformed and false binary choice between driving financial inclusion and protecting our financial system from abuse by illicit actors. New technologies at work today have the power and capability of addressing “actual” vs. “perceived” risk, strengthening coordination among and between financial market participants and intermediaries (both traditional and non-traditional) as well as financial regulators and law enforcement, and provide gateways for access in ways that can strengthen financial system controls for the many licit and otherwise legitimate activities and participants we need the system to serve, while strengthening the ability to identify and root out illicit activities.

These realities in financial and technological infrastructure force us to rethink and innovate financial inclusion opportunities and the attendant AML/FCC considerations in a new light. The increased globalization of finance, whereby counterparties can interact on an open-web-based platform in a peer-to-peer context without a specific regulated financial services intermediary with explicit regulatory and supervisory obligations, requires this new thinking as they provide gateways for financial inclusion and potential solutions to pressing development and national security goals in tandem.

These gateways and technologies can bring down barriers to access while preserving essential safeguards for traditional and non-traditional financial market participants. The strength of United States globally is founded on, among other things, a strong and unparalleled financial and economically resilient infrastructure. Extending this to the more than 25% of the country’s financially underserved and excluded—and ultimately to the 2.5-3 billion people globally underserved or excluded—including and especially our global neighbors—ultimately serves to drive overall financial system integrity and security moving forward, but also underpins our collective national security both at home and abroad.

ELLIPTIC

U.S. House Committee On Financial Services

Hearing on

When Banks Leave: The Impacts of De-Risking on the Caribbean and Strategies for Ensuring Financial Access

Wednesday, September 14, 2022, 10:00 a.m.
2128 Rayburn House Office Building & WebEx

Liat Shetret
Director of Global Policy and Regulation, Elliptic

Chairwoman Waters, Ranking Member McHenry, and distinguished members of the Committee, it is my privilege to address you at today's hearing on the topic of de-risking. Thank you for prioritizing this important topic. Today, I will focus my testimony on (1) why de-risking happens; (2) the consequences of de-risking; and (3) how technological innovations can help minimize the practice of de-risking.

My name is Liat Shetret. I am the Director of Global Policy and Regulation at Elliptic, the global leader and provider of anti-money laundering compliance solutions to virtual asset businesses and regulators globally for nearly a decade. We equip financial institutions, cryptoasset businesses, law enforcement and regulators with the tools and insights they need to manage risk, including for example, to identify, assess and act upon illicit and criminal crypto transactions recorded on the blockchain. Elliptic makes sense out of blockchain data, and identifies trends and typologies that help our customers understand and evaluate their risk exposure, and make risk-based decisions.

De-risking is Not a New Issue

In 2015, I co-authored a report – commissioned by Oxfam U.S. – titled Understanding Bank De-Risking and Its Effects on Financial Inclusion. In that report, we explored the drivers and responses to de-risking, highlighted case studies of financial access and provided recommendations for banks, regulators and bank customers who have been de-risked. Not much has changed in terms of the complexity and detriment of the de-risking problem. However, the urgency for addressing de-risking of correspondent banking relationships – specifically in the Caribbean and other regions – is significantly heightened.

De-risking – or de-banking – refers to the practice of financial institutions exiting relationships with and closing the accounts of clients perceived to be "unacceptably risky" or "high risk" based on the bank's risk tolerance. Rather than manage these risky clients, financial institutions may opt to end the relationship altogether, consequently minimizing their own risk exposure while leaving clients without access to the global banking system. According to the World Bank, there are over 1.4 billion people globally who are either unbanked or underbanked.

A 2021 survey from the World Bank revealed that over 37% of people cite cost as a primary barrier to banking. That number was nearly twice as high (60%) in Latin America and the Caribbean. Access to banking products has major implications not only for a country's financial resilience, but also its ability to access money in an emergency such as a natural disaster. There is also a stark gender gap in financial resilience in the Caribbean, where 56% of men can reliably access emergency money, but only 39% of women report being able to do so.

While de-risking practices have not been localized in any particular population, community or industry, in recent years there has been an "aggregation of results" best described as a trend toward de-risking of sectors, including correspondent banks and specific financial corridors and regions. These account closures have had a ripple effect on financial access for individuals and businesses who rely on access to financial services with regional and national security implications.

Drivers of De-risking

Financial institutions have significantly scaled back their risk appetites. These declining risk appetites – coupled with rising global scrutiny of anti-money laundering/countering the financing of terrorism (AML/CFT) – are the most commonly cited reasons for de-risking. Digging deeper, we note that underlying the practice of de-risking is the assumption that the affected customers present a higher risk of utilizing bank accounts as a medium for raising, moving, and storing funds that are somehow tainted by illicit activities such as money laundering, terrorist financing or tax evasion.

Specifically, correspondent banks – which provide back-end services such as check clearing, foreign exchange trading and fund transfers on behalf of other financial institutions – have been identified as a key vulnerability in AML/CFT regimes and are being de-risked. Profitability is also a factor in assessing correspondent banking relationships. In short, the risk is simply not worth the reward.

Consequences of De-risking and the Regulatory Response

De-risking is an issue that impacts the entire market. All invested stakeholders, banks, regulators and bank customers and clients appear to be acting rationally and in their own best interest. However, in doing so, they have created unintended consequences for market integrity, financial inclusion goals, AML/CFT objectives, and worryingly, compromised national security interests. This is because the risks are not being mitigated. Instead, risk is shifted to less visible places within the traditional banking system, so-called shadow banking - or outside of it altogether – something referred to as re-risking.

A lack of structured and systemic response to the issue of de-risking is perpetuating the challenge of regulatory arbitrage – the practice of utilizing more favorable laws in one jurisdiction to circumvent less favorable regulation elsewhere. Additionally, it potentially opens the door for China's implementation of its so-called Belt and Road Initiative – an expanded, interdependent market, designed to grow and build its economic power vis a vis mega-infrastructure and technology applications.

International standards urge financial institutions to adopt a risk-based approach (RBA). Regulators proactively advise financial institutions to assess their money laundering and terrorist financing vulnerabilities and to formulate policies and allocate resources according to their unique risk profiles and risk exposure. Although this approach is designed to allow for flexibility, it also introduces ambiguity and immense subjectivity around which actions are in fact required to meet international AML/CFT standards. Inappropriate risk avoidance has replaced effective risk management.

Rather than reducing the risk of criminal activity in the global financial sector, de-risking potentially increases systemic vulnerability. Pushing high-risk clients to become nested accounts in smaller financial institutions that may lack adequate AML/CFT capacities and controls. De-risking reduces visibility by well-regulated global institutions. Such a consequence was almost certainly not intended when the RBA was implemented and objectively does not increase security.

Conversely, financial inclusion is part of a broader strategy to reduce poverty, encourage economic development and promote access to financial services. The goals of financial inclusion, and adherence to AML/CFT obligations are not inherently in conflict. But tensions do emerge in practice. The international focus on financial inclusion – and simply "treating-customers-fairly" – has coincided with increased attention to AML/CFT frameworks, positioned as critical tools for advancing stability and security objectives, and for curbing criminal activity.

So how can these objectives be balanced?

Innovation and Technological Solutions to De-risking

De-risking is a problem of exclusion that is remedied by inclusion – specifically, the inclusion of actors and technology. For the Caribbean, convening an action-oriented task force or committee of affected parties – including financial institutions, regulators and trusted members of the private sector such as tech companies – will bring innovative solutions to historically challenging problems.

Congress should explore legislation to facilitate the acceleration of digital identification – offering clarity and certainty to an antiquated banking concept. As the digital economy has evolved, the need to update and expand the definition of compliance concepts such as customer due diligence and know your customer (KYC) rules has increased. Identity management now must consider reconciling online identities with offline identities as well as account for individuals who remain without identification altogether. New legislation should explore KYC elasticity – the idea that these rules can be expanded to fit economic developmental and security realities straddling digital and traditional markets. Improving access to financial services through technological improvements to authentication of identity can lower barriers to entry for those who are unable to access these services due to identification requirements.

Congress should expedite the exploration of blockchain-based tech solutions that enhance US dollar dominance globally – including stablecoins and central bank digital currencies (CBDCs). This will ensure that market efficiency, privacy concerns and interoperability with other economic blocs - such as with the Caribbean counterparts - will be well-considered,

CBDCs have an extremely high adoption rate in the Caribbean, with eight Eastern Caribbean countries having fully deployed one. As the US continues to explore the development of its own Digital Dollar, interoperability with other nations' CBDCs should be prioritized as a means to strengthen US competitiveness in the global economy and dramatically improve the deployment of capital to these regions.

Regulators should consider balancing punitive measures – such as sanctions, penalties and fines – with constructive models that reward risk mitigation through innovation, recognizing attempts to promote financial inclusion while retaining a robust approach to market integrity. Regulatory sandboxes allow the use of new regulatory tech and suptech tools such as blockchain analytics to be explored and enhanced, while reducing the impact on the broader financial system.

AML/CFT supervisors and prudential regulators should further leverage US delegations' engagement at international foras. For example, US representatives and counterparts at the Financial Action Task Force (FATF) and their regional counterparts, or other AML/CFT forums can push to expand on the risk-based approach. The provision of clear rules, or principles-based guidance where relevant to provide clarity about AML/CFT requirements involving those clients deemed inherently high risk will go a long way. Similarly, to promote the continued integration of financial inclusion into mutual evaluation methodologies developed by the FATF and the World Bank, national regulators should foster holistic strategies for the evaluation of money laundering, terrorism finance and financial inclusion.

Financial institutions could enhance their focus on corporate social responsibility by adopting strategies which are by nature more inclusive, relying on individual circumstance, nuanced customer due diligence and transaction monitoring than broad risk tiers or sectoral or jurisdictional assessment.

The banking sector could use the Wolfsberg Group and other industry fora to establish guidelines that enable effective compliance practices for dealing with crypto businesses. This will, for instance, allow banks to manage the risks while avoiding de-risking.

Blockchain analytics provide an example of how an innovative approach can work in practice to increase systemic security and enhance inclusivity. Blockchain-based accounts offer unique innovations such as end-to-end visibility of funds, showing where money *has* been and where it is going. They also allow for the pre-screening of an account before funds can be withdrawn and help identify potential exposure to sanctions. These are all blockchain-based innovative capabilities that are simply not possible with traditional finance.

Many challenges remain in addressing the balance between financial integrity and inclusion. However, there are also many opportunities to address these issues by operationalizing public-private sector initiatives that address concepts such as identity and transaction monitoring. Moving into a digitized economy gives banks the opportunity to innovate, manage and mitigate risks effectively. Tech innovations serve as an enabler to every stakeholder involved in the de-risking conundrum.

Thank you for the opportunity to speak here today and I welcome your questions, discussion and follow up.

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Statement for the Record

Of the

BAFT (Bankers Association for Finance and Trade)

Before the

Committee on Financial Services

Of the

United States House of Representatives

On

September 14, 2022

Chairwoman Waters, Ranking Member McHenry, and Members of the Committee:

BAFT (Bankers Association for Finance and Trade) is grateful for the opportunity to provide a statement for the record for the Committee's hearing on "When Banks Leave: The Impacts of De-Risking on the Caribbean and Strategies for Ensuring Financial Access."

BAFT is an international financial services industry association whose membership includes nearly 300 financial institutions and solution providers throughout the global community. Our members are active in correspondent banking, acting as both providers and users of correspondent banking services. Correspondent banking is vital to cross-border economic commerce, and is particularly essential in the Caribbean, where there is a high dependence on foreign goods, services, and connectivity to the U.S. financial system. Banks have adopted a risk-based approach to correspondent banking, consistent with regulatory guidance.

In the context of correspondent banking, de-risking has been used to describe the practice of exiting correspondent banking relationships due to excessive risk associated with the respondent bank. These relationships, however, are often discontinued because of high costs or a strategic change in business or market focus of the correspondent. Putting aside the latter, the most fundamental reason for de-risking is an imbalance in a simple equation: **cost + risk > value of the business**. However well intentioned, any potential solutions to de-risking must address that imbalance.

Contributing costs can include initial customer due diligence (CDD), customer onboarding, annual maintenance, periodic Know Your Customer (KYC) reviews, transaction monitoring (on top of core transaction processing costs), and compliance reporting. Risks can include country-level risk, institutional-level risk, transaction-level risk, and reputational risk if something goes wrong. In

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addition, money laundering violations could result in significant fines and penalties valued well in excess of the income related to the business. Increased respondent bank risk can also increase the cost of due diligence, transaction monitoring, and compliance reporting.

Private and public sector stakeholders have undertaken efforts to reduce the costs and risks associated with correspondent banking; however, de-risking is still an issue in some jurisdictions such as the Caribbean. BAFT participated in the April roundtable hosted in Barbados by Chairwoman Waters and Prime Minister Mottley and supports several of the recommendations coming from that meeting, including the harmonization of standards and best practices, the establishment of a certification for examiners, additional training for bankers, and a commitment to ongoing forums to improve outcomes.

We also believe that to make a material difference in the outcomes for de-risked banks, we must consider some material shifts in approach. We encourage the Committee to consider the following.

Establish a Licensing Framework for Respondent Banks

Establishing a framework whereby respondent banks are "licensed" to be eligible for correspondent bank accounts could significantly reduce redundant CDD costs. The "agent" would conduct thorough due diligence and transaction analysis, and if deemed acceptable, the respondent would be issued a license. Correspondent banks could rely on this license, limiting the amount of due diligence they also conduct, and would also be limited from penalties for banking a licensed respondent.

Consider the parallel to the licensing framework for drivers. The government authorizes agencies to conduct background checks, administer assessments to ensure the applicant understands applicable laws and rules, and conduct a field assessment to verify that the applicant can safely perform what's needed (in practice). After satisfying all the requirements, the applicant receives a license. Rental car companies can rely on this license when renting a vehicle. They may impose insurance and additional conditions (e.g., minimum age, credit card, etc.). However, if a customer happens to use the rental car in the commission of a crime, the rental car company has limitations on its liability provided they rented to a properly licensed driver. If each rental car company were required to conduct its own background checks, driver tests, and were subject to large fines or penalties if one of its customers used the rental vehicle while committing a crime, the entire industry might collapse under its own weight, and car rental companies would significantly restrict to whom they rented cars based on risk profile. Applying a similar licensing framework to correspondent banking could lower both the cost and risk to correspondent banks.

Designate a Correspondent Bank for Qualified Institutions

Like development banks, an institution could be established or designated for the purpose of serving as a correspondent bank for qualified institutions that cannot obtain a correspondent relationship elsewhere. This potentially solves for institutions whose business is too small, but not too risky. The respondents would still be subjected to due diligence to ensure they meet minimum compliance standards and are not a magnet for illicit funds flow. From a regulatory perspective, the designated correspondent would be supervised with the explicit understanding that they are supporting de-risked institutions. It may be necessary to subsidize the operations of this entity but could potentially be packaged as part of foreign aid in collaboration with the governments of the respondent.

Clarify Hub Banking Protocol

Like the correspondent scenario discussed above, some medium sized banks with strong knowledge of the market and lower operating costs may choose to provide downstream correspondent services to small banks. Many of these institutions are respondent banks, and these arrangements are often referred to as "nesting." Regulators have sent mixed signals as to the acceptability of these arrangements, causing many upstream correspondent banks to re-evaluate their relationships with hub banks providing downstream services. This can be a disincentive to banks to act as hub banks, for fear of losing their own correspondent relationships. Providing clarity and guidelines for these arrangements might incentivize banks in the Caribbean (and other regions) to aggregate business for smaller institutions, thereby increasing the value of the business for an upstream correspondent.

Each of the above recommendations requires full vetting and must be done in a way that does not jeopardize the integrity and resilience of the financial system. However, each addresses the imbalance in the core equation that usually triggers de-risking. We would be happy to lend support to develop these ideas further.

Thank you again for the privilege of providing the Committee with our views.

14 September 2022

Statement for the Record

On behalf of the

Caribbean Community (CARICOM) Secretariat

before the

Committee on Financial Services

United States House of Representatives

CARICOM Caribbean Community Secretariat

14 September 2022

Statement for the Record

On behalf of the

Caribbean Community (CARICOM) Secretariat

before the

Committee on Financial Services

United States House of Representatives

14 September 2022

Chairperson Waters and Members of the House Financial Services Committee, the Caribbean Community (CARICOM) Secretariat appreciates the opportunity to submit this statement for the record on the impact of de-risking and the loss of Correspondent Banking Relations with Global Banks in the United States.

1. Background

1.1 **De-risking** and the resulting loss of international correspondent banking relationships (CBRs) undermines the economic prosperity of CARICOM Member States. De-risking leads to higher transactions costs which negatively impacts the competitiveness of CARICOM businesses involved in international trade and commerce. De-risking also causes financial exclusion, particularly of specific customer segments (including money transfer services and charitable organisations which support the poor) thereby causing hardship and deepening of social tensions within CARICOM Member States and across the Community. Moreover, financial exclusion results in increased cash transactions within our jurisdictions, thereby increasing some of the very risks that de-risking is intended to mitigate in the global financial system. The banking sector in the Caribbean Community, has been disproportionately impacted compared with other regions worldwide having lost over 40% of active US dollar correspondent banks between 2011 and 2020,. Many CARICOM banks (and particularly, indigenous banks) have only been able to retain one correspondent bank, often small third tier banks, which has resulted in higher industry concentration and transactions costs for cross-border payments.

1.2 CARICOM Member States recognize the importance of ensuring that financial systems, both global and in the Caribbean Community, are not used to facilitate illicit financial flows. Our Member States have therefore been engaged in the process of legal and regulatory reform to reduce the risk of money laundering and terrorism financing through our banking systems. The de-risking strategy adopted by global banks is driven by the heightened regulatory stance of Governments in advanced countries and international authorities such as the Financial Action Task Force (FATF) towards combatting money laundering and terrorist financing practices via the banking system. Moreover, regulatory authorities threaten to impose huge fines on banks for infractions of due diligence procedures. This threat has become a deterrent to the continued provision of CBRs to CARICOM banks because of the perception that they are located in high-risk jurisdictions requiring more intensive monitoring and compliance procedures. These additional costs cannot be offset by the relatively low profits associated with the volume and size of the financial transactions emanating from CARICOM Member States. This situation has worsened with the recent withdrawal of the branches of primarily foreign-owned banks from several CARICOM Member States.

1.3 In the case of CARICOM banks, risk perception emanates from mainly two (2) sources – the FATF compliance reports and the United States International Narcotics Strategy Report (INCSR): Money Laundering. These reports represent a fair degree of arbitrariness in the global financial architecture which has profound implications for CARICOM Small States. Both reports have adopted a listing strategy which effectively conveys the impression that listed jurisdictions have serious deficiencies in their AML/CFT frameworks and are therefore perceived as high risk for financial criminal activity. Inclusion on these lists is NOT a result of actual wrongdoing but is a result of the application of a set of processes and procedures that, invariably, do not take account of the small size of CARICOM States, and relatedly, the small volume of financial transactions relative to global flows. These misperceptions must be addressed so that CARICOM Small States can retain access to the global financial system in a fair and transparent manner that allows for social and economic progress.

2 The Issue of Listing

2.1 The FATF mutual evaluation reports and outcome statements are a major source which informs the risk perception of CARICOM States. Currently, the Fourth Mutual Evaluation process, which assesses technical compliance and effectiveness of AML-CFT regimes, is underway. These evaluation reports provide an in-depth description and analysis of a country's framework for preventing criminal abuse of the financial system and serve as the basis for the determination of whether a country has serious deficiencies. As at June 2022, the FATF had identified 23 countries as being subject to increased monitoring including four (4) CARICOM Members – *Barbados, Cayman Islands, Haiti and Jamaica*. The entry of two of these countries onto the FATF's Grey List was due to a change in the FATF listing criteria which re-classified their financial system assets thereby placing them in scope for enhanced monitoring. This is an example of the unevenness and arbitrariness of the listing process.

2.2 The European Commission utilizes the FATF grey list as the starting point for the identification of high-risk jurisdictions with strategic deficiencies in their AML CFT regimes. This is then complemented by an autonomous assessment of the risk profile and the level of threat to which the country is exposed through an analysis of the legal framework and its effective application using more rigorous standards. The European Commission blacklist includes five (5) Caribbean States to which new **protective measures** could be applied with the objective of protecting the integrity of the European financial system. These measures, which include enhanced customer due diligence protocols and prohibitions on financial transactions involving blacklisted countries, could have serious impacts on the growth and development trajectory of small states.

2.3 The *International Narcotics Strategy Report (INCSR): Money Laundering* Report is prepared annually by the United States Department of State and has consistently identified almost **all CARICOM Member States as major money laundering jurisdictions**.[1] The Report contains an extensive survey of actions that countries would have undertaken to combat money laundering and terrorist financing practices along with the policy and institutional gaps and deficiencies. **However, CARICOM Member States are concerned about the non-consultative process used for the preparation of this Report and not being given the opportunity to validate the country-specific findings before the Report is published**. The listing contained in this Report identifies CARICOM Member States as high risk jurisdictions and therefore requiring enhanced regulatory scrutiny, monitoring and compliance procedures. The higher compliance costs associated with more intensive procedures applicable to jurisdictions that are deemed to be high-risk, relative to the

[1] The 2022 INCSR (issued in March 2022) listed the following CARICOM Member States as **major money laundering jurisdictions** for 2021 – Antigua and Barbuda, The Bahamas, Barbados, Belize, British Virgin Islands, Cayman Islands, Dominica, Guyana, Haiti, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname and Trinidad and Tobago.

profitability margins associated with Caribbean financial transactions, have precipitated the de-risking response overtime.

3. Developments in AML/CFT Regulation and Enforcement

3.1 Against the background of heightened interest in AML/CFT compliance at the national and global level, the Caribbean Community acknowledges the United States National Defense Authorisation Act (NDAA), which came into effect on 1 January 2021 and comprises two pieces of legislation – the *Anti-Money Laundering Act of 2020 (AMLA)* and the *Corporate Transparency Act of 2020*. The Community also acknowledges that the AMLA considerably strengthens and rationalizes the AML/CFT legal, regulatory and enforcement framework in the United States while acknowledging the impact of the de-risking strategy. However, the Caribbean Community is concerned about those provisions of the AMLA which have the potential for investigative and judicial over-reach in respect to foreign financial institutions. These provisions also create additional obligations for United States financial institutions to keep records and monitor foreign banks which are under investigation as well as terminate their CBRs. The requirement for the disclosure of beneficial ownership information on any foreign company formed under the laws of a foreign country but which is registered to do business in the United States can become another compliance criterion for determining the effectiveness of the AML-CFT regimes in CARICOM small states.

4. **Easing the De-Risking Burden**

4.1 Whilst de-risking is essentially a business decision by global banks, the heightened regulatory stance as well as the arbitrary and uneven processes and procedures by which countries / regions are assessed as high-risk jurisdictions are the drivers of this categorization. The tendency to de-risk may, however, be eased by the adoption of systemic changes by both the global standard-setting authorities like the FATF and the Governments in advanced countries like the United States. Such changes could include –

(i) Levelling the playing field regarding the identification of jurisdictions with strategic deficiencies which appears to disproportionately target developing countries;

(ii) Application of a higher threshold for the identification of high-risk jurisdictions which could involve the determination of whether there is material evidence of money laundering or terrorist financing activity in the country; and

(iii) Adopting the "*safe harbour concept*" to differentiate between those jurisdictions which would be eligible for less stringent restrictions on the provision of CBRs. Such countries would have to maintain compliance with FATF standards and achieve ratings which match or surpass that awarded to the United States as well as demonstrate a high level of cooperation with the United States on AML/CFT enforcement.

4.2 These systemic changes, along with the proposals that have already been tabled to continue the strengthening of AML-CFT regimes and due diligence practices of respondent banks in CARICOM, together with efforts to provide regulatory certainty could contribute to easing the de-risking burden and support the beneficial integration of CARICOM small states into the global economy.

EMBASSY OF ANTIGUA AND BARBUDA

Statement for The Record

On

The U.S. House Committee on Financial Services hearing entitled:

"When Banks Leave: The Impacts of Derisking on the Caribbean and Strategies for Ensuring Financial" Access

September 14, 2022

Ending De-risking in the Caribbean
Eliminating Risks for the World

Ten Practical Ideas for International Co-operation to Maintain the Caribbean's Inclusion in the Global Financial and Trading System

by

Gaston Browne
Prime Minister of Antigua and Barbuda

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Preface

In 2014, as he was elected as Prime Minister of Antigua and Barbuda, Gaston Browne was asked to assume lead responsibility for financial matters in the quasi-Cabinet of Heads of Government of the Caribbean Community (CARICOM).

An important part of that role is combatting the adverse effects of 'de-risking' and the consequent withdrawal of correspondent banking relations (CBRs) from banks in the entire Caribbean region by global banks in the United States of America and the United Kingdom.

This withdrawal of CBRs, if it continues unabated, runs the risk of excluding the entire Caribbean from the world's trading and financial system, plunging the region into economic decline, and creating an underground organization for financial flows that are illicit and outside of regulatory control.

The problem is acute and it continues to hang over the region like the sword of Damocles, largely because of inaction by major governments and despite many studies conducted by international financial and development institutions pointing out its adverse effects and its irrationality.

This paper by Prime Minister Browne explains the dangers that 'de-risking' poses for the Caribbean and the consequences for the wider global community. Constructively, in calling for all stakeholders to address the problem with the urgency its deserves, the Prime Minister offers 10 practical ideas for co-operative action.

May 2018

Ten Practical Ideas for International Co-operation to Maintain the Caribbean's Inclusion in the Global Financial and Trading System

By Gaston Browne
Prime Minister of Antigua and Barbuda

In recent years, the international community has begun to focus on financial inclusion as part of a broader strategy to reduce poverty, encourage economic development, and promote stability and security. This is a good development and one that small states in the Caribbean welcomed.

However, the international focus on financial inclusion has coincided with increased attention to anti-money laundering and countering the financing of terrorism (AML/CFT) frameworks as crucial tools for advancing stability and security objectives and for curbing criminal and violent extremist activity. This, of and by itself, is not a bad thing and it is also welcomed by Caribbean states.

But, regrettably, the good intentions of the international community's focus on financial inclusion is being compromised by a narrow focus on AML/CFT only. This has resulted in regulators' increased scrutiny of the formal and informal financial sectors, as well as international pressure on global banks, particularly those in the United States of America and the United Kingdom, to shy-away from doing business with banks and other financial institutions in any jurisdiction about which allegations – substantiated or not - have been made of being a "tax-haven" or having the potential for money laundering.

Global banks in U.S. have been told by their regulatory bodies that they face huge penalties in the event that they facilitate – even if unintentionally - money laundering and other forms of financial crime, including tax evasion. This has led to the phenomenon of "de-risking".

What is De-Risking?

De-risking is a vague and amorphous term that has been interpreted differently by as many organizations that have attempted to define it. Essentially, global banks terminate banking relations with clients in jurisdictions that have been labelled as either "tax havens" or "high risk" for money laundering, whether or not the jurisdictions are innocent or have established practices that conform to the highest international standards.

But, in effect, as the World Bank has asserted: "De-risking practices by global financial institutions threaten to cut off access to the global financial system for remittance companies and local banks in certain regions, putting them at risk of losing access to the global financial system."

Why has De-risking Come About?

As two experts describe it: "In an effort to bolster the fight against financial crime, to meet regulatory expectations and to avoid further enforcement, global financial institutions are continuing to invest millions of dollars in their compliance functions. However, financial institutions are also grappling with the question of whether, in the context of managing certain risks, it is simply more cost effective (and less troublesome) to pull out of doing business in relevant sectors or markets".

Faced with the prospect of heavy fines, even for the most minimal and unintended infraction of AML/CTF requirements, financial institutions have increasingly decided to avoid, rather than to manage, possible money laundering or terrorist financing risks, by terminating business relationships with entire regions or classes of customers. This approach defeats the basic business purpose of banks which, as fiduciary institutions, should accept the role of managing and mitigating risk rather than simply ending relationships with clients.

This so-called 'de-risking' practice has negatively impacted correspondent banking relations (CBR's) which is vitally important to the global trading and financial system. The Caribbean has been hit particularly hard by this decision.

De-risking is not only an existential threat but one of the most egregious acts committed against small and vulnerable states in the Caribbean.

The consequences of de-risking - intended or unintended - could be more devastating than any natural disaster. If it is allowed to continue unabated, de-risking poses the real risk of de-banking small, vulnerable states in the Caribbean. Therefore, this artificial, exogenously-imposed construct has increased the vulnerability of small island states in the Caribbean.

It is significant that a recent working paper of the International Monetary Fund (IMF) noted that, "The Caribbean region has many characteristics that could potentially pose barriers to financial development and inclusion: the countries' small size and scale, prolonged low growth, high debt, and vulnerability to external, including natural disasters and the recent loss of correspondent banking relations" as a consequence of de-risking strategies employed by global banks, particularly in the United Sates (U.S.) and the United Kingdom (U.K.).

The Vital Importance of Correspondent Banking Relations

De-risking has had its most harmful effect on the Caribbean by causing the withdrawal of Correspondent Banking Relations (CBRs) from banks in the region.

Correspondent banking enables the provision of domestic and cross-border payments, supports economic growth through international trade and cross-border financial activity, including remittances. Traditionally, the main CBR providers in the Caribbean were in the U.S., the U.K. and Canada. Now, the region's banks, apart from the Canadian-owned ones, have to go further afield. When these CBRs are withdrawn, the capacity of the affected countries to participate in the global trading and financial systems is severely constricted.

As a recent World Bank study explains: "To move funds internationally, banks rely on CBRs, roughly defined as the provision of banking services by one bank (the correspondent) to another bank (the respondent). CBRs are essential to international payments and provide an essential nexus between local economies and jurisdictions and the international financial system. They underpin international trade, remittances, and humanitarian financial flows among countries and are therefore particularly relevant to developing countries to support economic growth and development".[1]

The vital importance of CBRs, has been emphasized by the Managing Director of the International Monetary Fund (IMF), Christine LaGarde, who observed: "Correspondent banking is like the blood that delivers nutrients to different parts of the body. It is core to the business of over 3,700 banking groups in 200 countries. A global bank like Société Générale, for example, manages 1,700 correspondent accounts and processes 3.3 million correspondent transactions every day".[2] The IMF President stressed that the decline of correspondent banking relationships is "a serious concern for those countries that have few avenues for participating in the global payment and settlement systems"[3]. She stated that "these countries, too, need to ensure an efficient allocation of capital. And they need ways to empower the poor and the small to participate in the economy".[4]

Loss of CBR's: Impact on the Caribbean

The indiscriminate application of de-risking strategies, such as the withdrawal of CBR's, and the attendant financial shocks, have already disrupted the payment systems in the Caribbean and it could get worse, with far reaching socio-economic consequences for the region's open economies that are dependent on trade (especially in services) and investment. These consequences include: impeding trade and investment flows, distorting competition and undermining human development.

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[1] The Decline in Access to Correspondent Banking Services in Emerging Markets: Trends, Impacts, and Solutions Lessons Learned from Eight Country Case Studies, World Bank Group, Washington DC, 2018
[2] Speech to the New York Fed, "Relations in Banking – Making it Work for Everyone", July 18, 2016
[3] Ibid
[4] Ibid

Even basic payments for medicines, education, healthcare, tourism receipts and remittances could be threatened, as financial intermediaries in advanced countries seek to de-bank small, vulnerable countries from the international payment system.

All Caribbean jurisdictions have suffered the loss of CBR's. In some cases, banks have become reliant on only one correspondent bank. This has forced Caribbean banks to look further afield for CBR's to settle their transactions, including with the United States which is their largest trading partner and which benefits to the tune of more than $6 billion in trade surpluses with the region every year.

Consequently, bank costs have risen and so have the costs of settling payments for goods and services imported into and exported from Caribbean countries. There has also been a subsequent rise in the cost-of-living and an increase in the cost of doing business. The latter has adversely affected the competitiveness of the region in the global economy.

De-risking in the Context of AML/CTF

De-risking is not in line with the Recommendations of the Financial Action Task Force (FATF), the primary body concerned with AML/CTF.

The FATF has itself said: that de-risking can result in financial exclusion, less transparency and greater exposure to money laundering and terrorist financing risks. In a Guidance Note, the FATF explained:

> *This guidance explains the FATF's requirements in the context of correspondent banking services. In particular, it clarifies that the FATF Recommendations do not require correspondent financial institutions to conduct customer due diligence on each individual customer of their respondent institutions' customers. The guidance also highlights that not all correspondent banking relationships carry the same level of*

money laundering or terrorist financing risks, hence any enhanced due diligence measures have to be commensurate to the degree of risks identified.[5]

Despite this FATF guidance, the phenomenon of U.S. financial institutions terminating or restricting business relationships with clients or categories of clients continues. It appears to be driven by fear of penalties by supervisory bodies in the U.S. and the United Kingdom. Therefore, global banks are seeking to avoid, rather than manage, risk.

This was confirmed by the President of the Financial Action Task Force (FATF), Roger Wilkins, who told the Financial Times in late 2014 that de-risking is "not so much a function of our standards as a fig leaf for the banks doing what they need to do and are going to do anyway by taking people off their balance sheets ... There is nothing in our standards that requires this 'blunderbuss' approach to de-risking".

The Situation with Correspondent Banks in the US

Regulators in the United States claim that they do not tell banks to withdraw CBRs as part of their de-risking strategies.

Daniel Stipano, Deputy Chief Counsel in the Office of the Comptroller of the Currency, stated that his agency "the OCC as a regulator doesn't tell banks whose business they should take on. Those are business decisions that the banks have to make themselves. But we also don't think ... that the answer, when it comes to providing banking services for higher risk clients, is to just dump them wholesale".

However, banks in the U.S. are getting mixed signals. As the International Finance Corporation (IFC) has observed: "Regulatory guidance on how to manage these risks is often vague and contradictory. As a result, to reduce their own risks banks have become more conservative and less discretionary when evaluating customers".[6]

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[5] Guidance on correspondent banking services, Financial Stability Board, 1 October 2016
[6] Can Blockchain Technology Address De-Risking in Emerging Markets?", EMCompass, Fresh Ideas about Business in Emerging Markets, International Finance Corporation (IFC), World Bank Group

The principal cause of de-risking and loss of CBR's in the Caribbean is the effect of the International Narcotics Control Strategy Report (INSCR), published by the United States Government, that, year after year, characterizes all Caribbean countries as "major money launderers".

All banks in the U.S. get that Report and their compliance departments are guided by it. Their fear of heavy U.S. fines in the event of any infraction, however small, has led these U.S. banks to shy away from Caribbean banks with which they had previously conducted untroubled business for decades. Ironically, there is no evidence that any bank licensed in the Caribbean Community (CARICOM) has ever been the cause of any fines imposed on any correspondent bank in the U.S., the U.K. or Canada.

Therefore, while Caribbean jurisdictions sacrifice revenues and employment – and even their sovereignty in some matters - to make themselves compliant with OECD, FATF and European Union requirements, that sacrifice counts for little with U.S. banks in the face of the pernicious condemnation by the U.S. INCSR of all Caribbean jurisdictions.

Note should be taken that the following countries in the Americas are also named in the U.S. INCSR as "major money launderers": Argentina, Brazil, Canada, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, and Honduras.

The difference between the countries named above and the Caribbean is that they all have more avenues for participating in the global payment and settlement systems through their own large banks. Canada, for instance, has many global banks with a presence in the U.S. and other markets for its transactions.

A further problem with the U.S. INCSR is that it does not evaluate the risk of a jurisdiction's impact on the global financial system. Thus, it equates small jurisdictions with less than $5 Billion dollars in deposits with major financial jurisdictions with tens of billions of dollars such as Canada, Mexico, the U.K. and France.

The harmful and wrongful effects of the U.S. INCSR is a disturbing matter that governments must address collectively to change the de-risking posture of U.S. global banks, or the situation will worsen not improve.

Correspondent Banking: A Global Public Good

Correspondent Banking is a global public good and should be available to all countries and their peoples.

The provision of correspondent banking service is also a fundamental human right. It is just as important as the provision of other basic services, including include water, electricity and broadband services.

Therefore, the provision of CBRs cannot be seen exclusively through the lens of geo-political interests, financial risks and profitability. To do so, would be unjust and would do nothing more than worsen the global inequalities that presently characterize the global economic system. To paraphrase the great American leader, Abraham Lincoln, the world cannot survive "half-free and half-slave".

The Fallacy of the Caribbean as a High-Risk Region

Many small island states in the Caribbean have been stigmatized as major tax havens and money laundering centres. But, the small size of these jurisdictions and the relatively minuscule volume of transactions, disprove this fallacious classification.

Antigua and Barbuda, for example, has under $5 Billion in total onshore and offshore banking assets, with less than a few dozen remittances daily.

It is instructive that there is a presumption of money laundering involving Citizenship by Investment flows to the Caribbean, while the very investors can move funds seamlessly, to invest in the Investment Residency programmes of developed states without any such characterization.

Interestingly, it is in these very developed countries from which de-risking is being pursued, that 95 percent of global illicit flows take place.

The focus on micro states in the Caribbean while side-stepping the major money laundering centers in developed countries, is counter-productive. The problem of money laundering and counter terrorism financing must be tackled in the countries where the problem is greatest and most prevalent.

The Cost of being Falsely Labeled as 'High Risk'

The creation of the perception that the Caribbean region is high risk and susceptible to financial crimes and tax evasion, has driven up the costs to both the domestic and international banks of providing the most basic banking services.

In addition, the time to complete transactions, which were once measured in hours or days, now take weeks and months to be processed, because of new and cumbersome due diligence requirements.

As a growing number of small banks no longer have CBRs in a global money centre, they are forced to establish relationships with smaller banks in Central America, Asia, Africa and the Middle East. Therefore, the transfer process is lengthened and cumbersome. This lengthened process has proved to be expensive and prone to errors, resulting in information delivery gaps and, sometimes, non-acceptance of payments. This is confirmed by a recent study conducted by the International Finance Corporation of the World Bank Group.[7]

Recently, some Caribbean banks have noted that certain global banks have decided not to accept transfers that include an intermediary bank. If this practice continues and widens to include other correspondent banks, many local Caribbean banks would be put out

[7] De-Risking and Other Challenges in the Emerging Market Financial Sector Findings from IFC's Survey on Correspondent Banking, Washington DC, September 2017; see: https://www.ifc.org/wps/wcm/connect/3d215edb-55da-4097-982c-e90409d6621a/IFC+2017+Survey+on+Correspondent+Banking+in+EMs+final+September+1.pdf?MOD=AJPERES

of business, thereby de-banking the region and increasing its vulnerability to foreign owned banks.

This, de-risking has resulted not only in closure of banks but also in loss of new business relationships, because of the inability of existing banks to establish correspondent banking relations. De-risking undermines competitiveness and is an impediment to trade, investment, growth and development.

The overall impact of de-risking has been revenue losses for all Caribbean governments, thereby undermining their ability to meet their financial obligations. It has also caused job losses and an increase in unemployment and poverty; increased transaction costs; reduced competitiveness in the global community; and a decline in the ease of doing business.

The opportunity costs of loss of business from de-risking, though unquantified, are significant.

De-risking as a Policy Tool

It should be noted that de-risking is a policy tool to sanction rogue or uncooperative states. De-risking should never be utilized as a tool to punish innocent people in cooperative and compliant countries in the Caribbean.

De-risking Not Effective for AML/CTF

In any event, de-risking in its present construct is not an effective long-term solution to AML/CFT and tax transparency.

In its present form, the ultimate result of de-risking, will be the marginalization of states, especially Small Island Developing States in the Caribbean, undermining their capacities to attain the UN mandated Sustainable Development Goals (SDG's).

The Injustice of De-risking

To whom much is given much is expected; therefore, the multi-national correspondent banks that control the international payment systems, have an obligation to provide corresponding banking services to all.

This is so, since small vulnerable states in the Caribbean, do not have access to any alternative international trade settlement hard currency and correspondent banking architecture, to settle their trade and investment transactions. They are at the mercy of these multi-National correspondent banks that are centralized in developed countries and on whom they are completely reliant for correspondent banking relations.

For instance, the IFC has observed that, "De-banking of money service businesses can impact global remittances, a vital source of finance for poorer countries that totals some $440 billion a year—over three times the amount of foreign aid disbursed".[8]

Clearly, there is no justice in the de-banking and barring of these countries from the international payment system. It undermines their ability to meet their development agenda without cause and injures them without any mechanism for remedy.

Withdrawal of CBRs Counter-productive to AML/CFT

The withdrawal of CBRs as part of a de-risking strategy is counterproductive to fighting the scourge of AML/CFT and other financial crimes. An effective strategy requires the commitment, inclusion and participation of all.

De-banking the majority of innocent masses in Caribbean countries, and elsewhere, to fight the risks of AML/CFT violations could never be a sustainable solution.

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[8] Op.Cit., Note 6

Also, de-banking countries and regions based on profitability, conflicts with the overriding social and moral responsibility of correspondent banks to provide all countries and regions with the mechanism to settle their trade transactions.

The exclusion of countries and regions from the international payment system will ultimately undermine the fight against illicit financial flows, by driving these payments underground, where they are likely to go undetected. Additionally, alternative informal payment mechanisms will be developed and utilized to cover these illicit transactions without traceability.

The effective management of financial crime risks, including AML/CFT, requires the inclusion and commitment of all stakeholders, in all countries and regions, if not the world is put at risk. Consequently, governments, regulators and the private sectors in all countries, must work collaboratively to fight financial crimes effectively and sustainably, while striving to preserve the international payments system for all, and not to disadvantage further the poor and underdeveloped.

Caribbean: A Co-operative Region

Money laundering, the financing of terrorism and other financial crimes are global problems that demand a global response. Such a global response will not be achieved by a handful of countries, however powerful they may be, unilaterally creating rules that they impose on others. A better, more sustainable response is one that takes account of the views and circumstances of all and, in that context, develops a universally acceptable strategy for addressing the problem.

Caribbean countries have not been averse to participation in wider efforts to tackle the problems of financial crime. All of them have participated in the Global Forum on Transparency and Exchange of Information for Tax Purposes of the Organization for Economic Co-operation and Development (OECD) and, through the Caribbean Financial Action Task Force (CFATF) in the implementation of the rules, euphemistically described as 'recommendations', of the FATF. They have each done so at great cost to themselves, including financing the legislative and enforcement machinery and through the loss of revenues and employment from businesses that have been sacrificed, and the higher costs to businesses they have managed to retain.

Indeed, as of February 2018, only one Caribbean jurisdiction has been listed by the FATF among the "Jurisdictions with strategic deficiencies", and even in respect of this jurisdiction, it has been acknowledged that it "has taken steps towards improving its AML/CFT regime, including the approval of the Counter Terrorism Strategy by the National Security Council, the issuance of a Case Prioritization Policy, and advancing legislation in a number of areas".[9] With regard to the OECD's ratings for cooperation with the international standard on exchange of information on request (the EOIR standard), again only one Caribbean country has been found to be non-compliant. Most of the Caribbean countries are "largely compliant" (the same category as the U.S., the U.K. and Canada) or "provisionally largely compliant".

Costs of compliance, that the Caribbean incurs, are not limited to implementation of OECD and FATF requirements. Additional costs have been incurred to comply with the U.S. imposed Foreign Account Tax Compliance Act (FATCA) that compel our jurisdictions to report to the U.S. Internal Revenue Service (IRS) on U.S. related assets in our financial institutions, as well as with the European Union's Base Erosion and Profit Shifting (BEPS) framework.

It should be noted that scarce resources have been expended on compliance with all of these organizations and governments. To provide those resources, Caribbean jurisdictions have had to forego spending on health, education and much needed development infrastructure.

Therefore, there can be no question about the Caribbean's co-operation in the effort to address financial crime in a meaningful way.

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[9] See, FATF website: http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/documents/fatf-compliance-february-2018.html

De-risking and Loss of CBRs Hurt International Business

De-risking and the loss of CBR's adversely impacts the Caribbean's trading partners and the companies that export goods and services to the region.

For instance, the U.S. enjoys a balance of trade surplus with the Caribbean region that is annually more than $6 billion. That sum of money represents both revenues and employment to the U.S. When Caribbean countries cannot pay for the goods and services they purchase from the U.S., jobs are lost, and income is sacrificed.

Especially affected will be the travel agents, tour operators, airlines and cruise ships that send passengers from the U.S. and elsewhere into Caribbean ports. They too need correspondent banking relationships to pay for the holidays and business trips of their passengers to a region that ranks very high on their tourism map.

Similarly, affected will be the agriculture and manufacturing communities from whom the Caribbean imports a significant quantity of food, construction material, and other goods and services.

If the region cannot pay for the goods and services that it imports and cannot be paid for the goods and services it exports, including tourism receipts, it will be constrained to seek markets elsewhere simply to survive.

This trade diversion will not be a swift process and, in any event, will be expensive since direct transportation links do not exist even with neighbouring countries in Central and South America. Consequently, in the transition period, Caribbean economies will deteriorate, and their vulnerability will increase.

By the same token, revenues and employment in existing trading partners, particularly the U.S., the U.K. and Canada, will also decline.

The Way Forward: 10 Ideas

The sustainable solution to de-risking is multi-faceted and requires a cooperative approach by all stakeholders in developed and developing countries alike.

Below, are 10 ideas concerning the elements of what would be an acceptable and fair global approach to de-risking that does not simply target Caribbean and other developing countries but also encompasses OECD and European Union member states.

- The international community should recognize the importance of balancing the appropriate steps to prevent illicit actors access to financial services with ensuring continued or expanded access to finance for companies, small businesses, households and individuals.
- There should be cooperation among governments, regulators, the private sectors, respondent and correspondent banks to strengthen the AML/CFT, tax transparency framework with harmonized rules in pursuit of their common interests. This alignment of interests in managing and curbing international financial crime risks should negate the need for any hostility or harmful knee-jerk de-risking decisions.
- Policy implementation timelines set by the FATF and the OECD Global Forum should be based on national capacity and not the one-size-fits-all implementation policy that is widely practiced.
- De-risking should be restricted to rogue, uncooperative institutions and countries, and not jurisdictions that cooperate with the OECD Global Forum and the FATF. Entire regions should not be broad-brushed as being "high-risk". Jurisdictions should be assessed according to their own merits.
- Correspondent Banks should focus on managing financial crime risks instead of risk avoidance. They too should build their capacity to manage the risks of correspondent banking instead of de-banking countries.

- Where appropriate, correspondent banks should give respondent banks sufficient time to remedy any deficiency in their AML/CFT and tax transparency framework
- There should be improved dialogue between respondent and corresponding banks to promote cooperation and to build capacity.
- Within developing countries, respondent banks should improve their risk management processes including strong KYCC.
- In the particular case of the U.S., there must be continuous efforts to alert the agencies of the Government and the U.S. Congress of the harmful effects of its annual INCSR which, year after year, wrongfully list Caribbean countries as 'major money laundering jurisdictions', thereby encouraging the withdrawal of CBR's from Caribbean banks.
- Technology should be introduced and utilized by correspondent and respondent banks to include: Fintech, block chain technology, for KYCC, to identify suspicious transactions and to ensure full traceability.

On the final point of technology utilization, it is worth noting the observation of The Bipartisan Policy Center on the implementation of block chain:

> "Block chain could give banks and regulators access to far more detailed transactional and cross-institutional data than is currently available, allowing them to peer deeper into financial networks to identify bad actors. Furthermore, the distributed nature of blockchain technology makes it difficult for criminals to falsify transactional data to cover their tracks. All of this could take place in real-time, giving law enforcement the precious time they need to identify terrorist plots before they happen. However, this additional speed would need to be balanced against privacy concerns that could arise depending on how such a system were implemented." [10]

[10] Why Blockchain Could Bolster Anti-Money Laundering Efforts, By Kristofer Readling, Justin Schardin, Bipartisan Policy Centre, June 2016. See: https://bipartisanpolicy.org/blog/blockchain-anti-money-laundering/

Alternative Pathways

Caribbean jurisdictions have to be realistic and practical in their own response to the severe problems caused by de-risking and the loss of correspondent banking relations. Part of such realism and practicality is that the 10 ideas presented in this paper may not be taken up by global stakeholders.

What then are Caribbean jurisdictions to do? Set-out below are some of the options that might be considered:

- Changing source markets for imported goods and services;
- Trade bartering with a wider group of countries than those that are now the Region's major trading partners;
- Holding central bank reserves in a balanced portfolio of currencies, instead of concentrating reserves in any single currency;
- Development of alternative payment systems through the use of digital currency, including crypto currencies; and
- Establishing a Caribbean owned correspondent bank in major capitals to settle transactions emanating from the region.

Summary and Conclusion

Representatives of Governments of the OECD countries must cast aside the policy briefs seen through an AML/CTF lens only. They have to see the problem of de-risking more broadly and realistically.

That means not limiting the discussion only to AML/CTF considerations but widening the scope of responses to recognize that: (a) no country should be excluded from the global finance and trading system; and (b) success in reducing poverty and curbing economic inequality requires international co-operation, including correspondent banking relations.

The ideas set-out for tackling de-risking and its consequences in the section above, titled, **The Way Forward: 10 Ideas**, are the least of what should be done by global stakeholders.

Such global stakeholders would be regulatory bodies and global banks in the U.S. and UK; the FATF, the OECD Global Forum, respondent banks and regulators in the Caribbean, the Financial Stability Board, the IMF, the World Bank and the Inter-American Development Bank, the Caribbean Development Bank, representatives of Central Banks and Finance Ministries, and private sector companies.

The IMF has the convening power to gather such stakeholders to address the consequences of de-risking in a comprehensive manner. We urge that the IMF convene such a gathering, sooner rather than later.

Until an appropriate meeting is organized to discuss the de-risking issue and to devise a fair, equitable and global approach to resolving its harmful consequences, it will continuously be studied with little practical action being taken. That would be nothing short of global neglect – a neglect that the Caribbean cannot afford, and that will ultimately have undesirable international consequences.

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BACK COVER

PHOTOGRAPH OF PRIME MINISTER GASTON BROWNE

Gaston Browne is the Prime Minister and Minister of Finance of Antigua and Barbuda. He was educated in banking and finance at tertiary institutions in the United Kingdom and Spain. He served as Commercial Banking Manager for a major banking consortium in Antigua and Barbuda, comprising offshore and onshore banks and a trust company.

He became an elected member of Parliament in 1999 and has been re-elected in four subsequent general elections. Between 1999 and 2004, he served as Minister of Planning, Trade, Industry, Commerce and Public Service Affairs. While in opposition in Parliament between 2004 and 2014, Browne returned to the private sector as a businessman and launched several successful ventures.

In 2013, he was elected as Leader of the Antigua and Barbuda Labour Party which he steered to victory in General Elections in 2014, becoming Prime Minister. In March 2018, he again led his party to success in General Elections, increasing its representation in Parliament.

His colleague Caribbean Heads of Government appointed him to have lead responsibility for financial matters in the quasi-Cabinet of Heads of Government of the Caribbean Community (CARICOM) in 2014 – a role that he has performed diligently, including by advocacy before international financial and development institutions, and private sector organizations.

EMBASSY OF SAINT VINCENT AND THE GRENADINES
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Our Ref: MOFA/EMB-DC
Note No: 27/22

The Embassy of Saint Vincent and the Grenadines to the United States of America presents its compliments to the U.S. House of Representatives Committee on Financial Services and has the honour to refer to the Hearing held by the Committee on September 14, 2022, entitled "When Banks Leave: The Impacts of De-Risking on the Caribbean and Strategies for Ensuring Financial Access."

To this end the Embassy is pleased to inform that attached to this communication is a statement for the record submitted by the Financial Intelligence Unit (FIU) of Saint Vincent and the Grenadines for consideration by the Committee.

The Embassy of Saint Vincent and the Grenadines to the United States of America avails itself of this opportunity to renew to the U.S. House of Representatives Committee on Financial Services, the assurances of its highest consideration.

September 30, 2022
Washington, DC

EMBASSY OF SAINT VINCENT AND THE GRENADINES TO THE USA

GOVERNMENT
OF
ST. VINCENT AND THE GRENADINES

YOUR FILE NO: **OUR FILE NO: LG 003.16**

M E M O R A N D U M

FROM: Director, Financial Intelligence Unit **DATE:** September 23rd , 2022

TO: Permanent Secretary, Ministry of Foreign Affairs

SUBJECT: **De-risking**

Having reviewed your correspondence dated September 22nd, 2022 and received on September 23rd, 2022, the FIU contacted the FSA, ECCB Resident Representative and domestic banks in the jurisdiction to ascertain the current state of the de-risking phenomena being experienced.

The ECCB indicated that they were not aware of any major derisking issues faced by Licensed Financial Institutions within Saint Vincent and the Grenadines. Further, there were no recent reports of loss of correspondent banking relationships.

One Bank indicated that it did not have an issue and have not had a problem in terms of their correspondent bank threatening to de-risk them. The bank indicated that they had gone through a significant period of remediation work on their customers and have been working with their main Correspondent Banker using a collaborative approach. They further indicated that the only issue they have experienced is de-risking of certain sectors e.g. Citizenship by Investment as there has been heightened attention and interest paid to this sector. Not necessarily to exit the relationships, but if the controls are not working then their correspondent banker will not be comfortable with them maintaining relationships with these clients.

A second bank indicated that between the period January 2018 to present, they have not experienced any issues as it relates to derisking.

Unfortunately owning the time constraints, we were unable to get information from the other domestic banks one of which is the largest domestic banks.

The FSA also provided information relative to the sector under their remit and the response is hereto attached.

As an FIU we note the impact that the annual International Narcotics Control Strategy Report (INCSR) has on the global perception of our jurisdiction, which can result in issues such as de-risking. It is unfortunate that this report does not adequately take into account the significant work done by jurisdictions to combat money laundering and terrorist financing as evidenced by the implementation of the FATF recommendations which is the global standard in the fight against money laundering and terrorist financing.

De-risking

As mandated by the FATF in their revised standards, jurisdictions should not be judged in a one size fits all exercise. An exploration of the risk and materiality of an issue must be done for each jurisdiction and publications made with this at its core. To make sweeping declarations without first highlighting the risk of a particular issue or event is simply disingenuous and unfair to a jurisdiction.

With best regards,

FINANCIAL INTELLIGENCE UNIT
ST. VINCENT & THE GRENADINES

LaTeisha A. R. Sandy
Director
Financial Intelligence Unit

FINANCIAL SERVICES AUTHORITY

The Financial Services Authority (FSA) is a governmental statutory body established pursuant to the provisions of the Financial Services Authority Act, No. 33 of 2011, to regulate the international and non- bank financial services in St. Vincent and the Grenadines.

De-risking and the International Financial Services sector

IMPACT

The negative impact of de-risking on the St. Vincent and the Grenadines international banking sector, are reflected below:

- Generally, a loss of USD correspondents in particular, has significantly reduced options and ability to perform USD transactional banking business;
- Reduced fee revenue as business volumes fall;
- Inconvenience to customers due to delays and unreasonable KYC requirements;
- Use of Payment Service Providers ('PSPs')[1] replaced Correspondent Banks (CBs) in some instances. As a result, there has been the following:
  - increase in agent and customer complaints as PSPs payments take much longer and require very stringent due diligence requirements.
  - these entities generally increase the cost of operations, as PSP payment solutions require much more back-office support due to their multifaceted systems. Each PSP has its own unique system which must be set up individually in each bank's core banking system, which is unlike the CBs which use the central SWIFT messaging system for example. The PSP options require IT support and system changes which increases cost of operations;
  - increased operational cost incurred by using PSP systems and third tier banks which charge higher fees;
  - PSP payment instructions can be complex;

- increased operational risk if the banks are unable to service clients' banking needs according to agreement;
- increased operational and reputational risks due to inability to facilitate wholesale banking such as placement of investments as well as USD credit card settlements;

[1] a third-party company that assists businesses to accept a wide range of online payment methods, such as online banking, credit cards, debit cards, e-wallets, cash cards, and more.

- reputational damage as a result of frequent changes in correspondent banking relationships;
- alternative payments options are very expensive, require additional and separate IT developments;
- time and resources spent in establishing new relationships;
- loss of a competitive advantage with respect to turnaround time; and
- overall reduction in revenue for the Banks which impacts the bottom line.

2017-2022 - EXPERIENCES OF INTERNATIONAL BANKS

The IFS department of the Financial Services Authority (FSA) would have had to engage the banking sector on several occasions and had discussions on the matter. The following was revealed:

- One licensed bank reported that the impact on its business had been negative.

- Another licensed bank, which was part of a large international/regional banking financial institution group structure and with restrictions on its banking business, was able to access CBR and did not have a challenge.

- In response to the CB crisis, a third bank had to seek alternative channels and managed to establish a relationship with a financial institution, a PSP which was a related entity due to common ownership.

- One bank maintains only one CBR which was obtained in Europe. This bank is not able to permit transactions for the clients or wholesale transactions in USD due to their own CB issues. However, payments in Euros and Pounds Sterling seem to be far less challenging. Notwithstanding, following an onsite visit by a second CB, the bank received positive reviews. This bank is pursuing another USD CBR which can facilitate USD transactions. This is welcomed as it is believed that the risk of having to rely on one correspondent bank would be alleviated. During discussions it was indicated that the bank is on the way to establishing a second CBR in the USA.

Derisking and the Credit Union sector

From January 2016 to December 2017, the non-bank financial sector in the jurisdiction was de-risked by all commercial banks owned by international banks. As such, all commercial banking activities by the sectors were performed through the sole national bank. This relationship allowed them to perform Corresponding Banking services with clients in the diaspora through the bank's wire transfer mechanism. Funds remitted through this medium were used for various purposes, including financing investments, payment of loans, and general remittances to relatives to facilitate construction and other economic activities.

However, this practice was abruptly discontinued in 2018 by the Bank to preserve existing correspondent banking relations. This move of abruptly ending the downstream services with the industry caused significant disruptions to the payments of loans and direct investments made by persons in the diaspora with some entities.

In 2016, the FIU issued the following statement in response to the action taken by one commercial bank against the credit union sector, and the FSA endorsed the views expressed by the FIU:

> *"The FIU adopts the FATF's position on de-risking, which it addressed in Paris in October 2014. "De-risking" was there described as the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage risk in line with the FATF risk-based approach. It was also noted that de-risking can be the result of various drivers and there is a misconception to characterize de-risking exclusively as an anti-money laundering issue. The FATF further maintains that de-risking should never be adopted by a bank to avoid implementing a risk-based approach, in line with FATF standards.*
>
> *The FATF Recommendations only require financial institutions to terminate customer relationships, on a case-by-case basis, where the money laundering and terrorist financing risks cannot be mitigated. This step is fully in line with anti-money laundering, counter-financing of terrorism (AML/CFT) objectives. What is not in line with the FATF standards is the whole-sale cutting loose of entire classes of customer, without taking into account, seriously and comprehensively, their level of risk or risk mitigation measures for individual customers within a particular sector.*
>
> *The current action taken by one commercial bank clearly goes against the FATF standards as it is a "whole-sale cutting loose" of the Credit Union sector. The reason being given for terminating these relationships (i.e., correspondent banking and third-party transactions) does not suggest that the Bank has seriously or comprehensively assessed the level of risk or considered the adoption of any risk mitigation measures and this can have a long-term damaging effect on the financial industry."*

Financial Services Authority
23rd September 2022

Statement for the Record

On behalf of

MoneyGram International, Inc.

before the Committee on Financial Services

United States House of Representatives

Chairwoman Maxine Waters, Ranking Member Patrick McHenry, and members of the House Financial Services Committee, MoneyGram International appreciates the opportunity to submit this statement for the record on the de-risking challenges in the Caribbean.

MoneyGram International, Inc. a global leader in the evolution of digital P2P payments, delivers innovative financial solutions to connect the world's communities. With a purpose-driven strategy to mobilize the movement of money, a strong culture of fintech innovation, and leading customer-centric capabilities, MoneyGram has grown to serve over 150 million people in more than 200 countries in the last five years. MoneyGram leverages its modern, mobile, and API-driven platform and collaborates with the world's top brands to serve consumers through its direct-to-consumer digital channel, global retail network, and embedded finance business for enterprise customers. MoneyGram is also a leader in pioneering cross-border payment innovation and blockchain-enabled settlement.

As a leading global remittance company, MoneyGram provides essential financial services to consumers who may not have access to traditional financial services all over the world including in the Caribbean. Increasing financial inclusion and access for the Caribbean in urban and rural areas is a key priority for MoneyGram. MoneyGram also participated in the *Caribbean Financial Access Roundtable* cohosted by Chairwoman Waters and The Honorable Mia Mottley, Prime Minister of Barbados. Many of the issues identified during the roundtable currently impact MoneyGram's business in the region.

Due to a long history of potential regulatory penalties, outdated anti-money laundering laws, and low volume of transactions, Caribbean governments and banks have seen a steady decline in correspondent banking relationships. The Caribbean nations and their people have struggled to send money home to friends and family abroad for life's basic needs, including medical costs, disaster recovery, and educational fees.

Money service businesses and banks receive heightened regulatory scrutiny when transacting with consumers who may be sending money back to certain geographies. These institutions also face concerns about the potential reputational consequences among the public for operating in these countries. Banks may also face an unspoken pressure from regulatory bodies which leads to the withdrawal of foreign correspondent banking relationships and the closure of money service business accounts. The risk appetite of these institutions is rapidly declining, and Caribbean nations face a dire situation of financial exclusion.

For the purpose of combatting de-risking in the Caribbean region, MoneyGram proposes the establishment of a limited-duration pilot program. The proposed program helps facilitate the transfer of personal remittances to individuals through low denomination transactions without the fear of supervisory action from state and federal agencies for simply facilitating transactions to and from this region. Each financial institution should continue to be subject to all existing Bank Secrecy Act and federal/state anti-money laundering regulations while participating in the program. Federal regulatory bodies should examine the impact of the program after a limited duration of time to determine the program's success in increasing remittance flows in this region and protecting these small value transactions from potentially fraudulent activity.

The impacts of de-risking have been well-known for years. Now is the moment to offer real, tangible solutions that could alleviate the challenges faced by financially vulnerable populations.

Pilot Program to Combat De-Risking in the Caribbean

Purpose: To establish a pilot program that safely facilitates the transfer of personal remittances to individuals through low denomination transactions in economically diverse Caribbean countries

(A) Not later than 1 year after the date of enactment of this paragraph, the Secretary of the Treasury shall issue rules, in consultation with the Director of the Financial Crimes Enforcement Network, establishing the pilot program described below.

(B) Considerations. The Secretary shall ensure a safe harbor provision that authorizes financial institutions to engage in transactions that are ordinarily incident and necessary to the transfer of noncommercial, personal remittances and;

(I) are limited to transaction amounts under $1,500 U.S. Dollars
(II) are limited to a monthly transaction aggregation of $10,000 U.S. Dollars per customer
(III) are limited to transactions sent and received from the Bahamas, Barbados, Belize, Trinidad & Tobago for the purpose of the pilot program

(C) The pilot program shall ensure that –

(i) the financial institution shall not be liable for processing this transaction;

(ii) no Federal or State department or agency may take any adverse supervisory action with respect to the financial institution solely for processing this transaction request.

(D) Rules of Construction. Nothing in this section may be construed –

(i) to alter existing Bank Secrecy Act/ Anti-Money Laundering (BSA/AML) legal or regulatory requirements, nor does it establish new supervisory expectations;

(ii) to prevent a Federal or State department or agency from verifying the validity of a transaction;

(iii) to relieve a financial institution from complying with any reporting requirements or any other Bank Secrecy/ Anti-Money Laundering (BSA/AML) provisions, including the reporting of suspicious transactions;

(E) Implementation Updates. Not later than 360 days after the date on which rules are issued, and annually thereafter for 3 years, the Secretary of the Treasury, or the designee of the Secretary, shall brief the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on—

(i) the effectiveness of the pilot program in preventing de-risking in the designated Caribbean countries and the mechanisms that may improve that effectiveness of facilitating remittances;

(ii) the effectiveness of the pilot program in keeping person-to-person remittances safe from institutions or individuals who may be engaged in fraudulent activities, money laundering, or terrorist financing activities;

(ii) recommendations to amend the design of the pilot program;

(iv) extension of the geographical scope of the program;

(F) The program will exist for 3 years with a renewal of 2 years at the discretion of the Secretary.

APRIL 2022

ANTI-MONEY LAUNDERING REGULATION, CORRESPONDENT BANKING, AND THE ADVERSE ECONOMIC EFFECTS FOR THE U.S.-MEXICO BILATERAL RELATIONSHIP

Robert Shapiro
with Isaac Yoder

SONECON

TEXAS ASSOCIATION OF BUSINESS
THE TEXAS STATE CHAMBER

TABLE OF CONTENTS

EXECUTIVE SUMMARY

In 2020, financial payments and transfers between Mexico and the United States totaled more than $750 billion. Foreign direct investments (FDI) between the two countries accounted for $14 billion with the stock of U.S. FDI in Mexico totaling $101 billion and the stock of Mexican FDI in the United States totaling $21 billion. In addition, the United States imported $393 billion in goods and services from Mexico, and Mexico imported $307 billion from the United States. Financial remittances to Mexico totaled $51.6 billion in 2021, including $49 billion from the U.S.

These financial flows have substantially occurred through correspondent banking relationships involving hundreds of thousands of daily transfers between banking institutions in Mexico and the United States. However, since the Patriot Act of 2001, U.S. regulators have targeted correspondent banking between these two countries as part of an intense anti-money laundering (AML) and anti-terrorist financing (CFT) campaign. This study examined the basis for this continuing campaign, and we have concluded that these efforts have become ineffective, misplaced, and costly for the American economy.

First, the regulatory AML/CFT regime for correspondent banking is ineffective.

- Worldwide, government authorities manage to seize a very small share of the estimated $1 trillion to $3 trillion in funds laundered annually.

- Criminals often attempt to evade "Know Your Customer" rules for banks by using bogus identities and creating multiple tiers of shell companies, trusts and foundations registered across several countries and hiring "nominee" directors and officers with no knowledge of an account's ultimate owners or beneficiaries.

- Criminals also increasingly use "shadow banking" arrangements beyond banking regulation, including internet-based transfers, blockchain cryptocurrency payments, and complex financial derivatives, as well as informal transfer systems that shift funds anonymously through networks of intermediaries in currency exchanges, stock brokerages, casinos, and auto dealerships, and through cash purchases of real estate, gems, and precious metals.

Second, focusing AML/CFT regulation on U.S.-Mexican correspondent banking is misplaced. The International Monetary Fund (IMF) found that over the last decade, Mexico put in place a mature AML/CFT system based on international standards, and the World Bank commended Mexico for its transaction databases and monitoring of cross-border transfers.

- The Basel Institute on Governance also found that the AML/CFT system in Mexico is superior to 60 other countries, including Cayman Islands, Thailand, Saudi Arabia, and Hong Kong.
- Further, the Tax Justice Network (TJN) found that Mexico's banking system is more transparent than those in 109 other countries, including the U.S. Japan, Canada, and Israel. The TJN also found that Mexican banks are "tiny" players in international financial transactions, handling less than one-tenth of one percent of those transfers worldwide.
- Mexico's broad conformity with international AML/CFT standards and practices and the transparency of its banking system support a review of its current risk status by regulators of correspondent banking.

Third, current AML/CFT regulation of correspondent banking between Mexico and the U.S. entails significant economic costs as Mexican and U.S. banks responded by "de-risking": They reduced their correspondent banking relationships or ended the services to avoid possible fines and reputational damage and to preclude attracting broader scrutiny from banking regulators.

- Correspondent relationships declined 30.5 percent in Latin America and 12.2 percent in North America by 2020. Such relationships involving smaller and regional Mexican banks declined 34 percent, and the value of those transactions fell 8 percent even as those values increased in Brazil, Argentina, and other large Latin American countries.

Econometric analysis showed that the regulatory focus on correspondent transactions between U.S. and Mexican banks from 2012 to 2018 and the associated de-risking had significant adverse economic effects, ...reducing growth in the U.S. stock of FDI in Mexico by an average of

$1.4 billion in a given year.

- Econometric analysis showed that the regulatory focus on correspondent transactions between U.S. and Mexican banks from 2012 to 2018 and the associated de-risking had significant adverse economic effects, slowing FDI from Mexico to the United States by an average of $480 million in a given year, reducing growth in the stock of FDI in the United States by an average of $3.3 billion in a given year, and reducing growth in the U.S. stock of FDI in Mexico by an average of $1.4 billion in a given year.

- As a result, this focus on correspondent banking activity between the United States and Mexico dampened U.S. GDP growth from 2012 to 2018 by an average of 0.03 percent per-year for a cumulative slowdown in GDP growth of $38.3 billion. Moreover, these GDP effects slowed U.S. employment growth by 41,000 jobs per-year or 285,000 jobs from 2012 to 2018.

- Econometric analysis also showed that the decline in correspondent banking relationships associated with misplaced U.S. AML/CFT efforts slowed Mexico's exports to the United States by $74 billion from 2011 to 2021, dampening U.S. employment growth by 114,000 jobs.

- Current U.S. scrutiny of correspondent banking also impedes transfers of bulk dollars to U.S. banks from Mexican institutions collected from tourist spending, "pocket" remittances, payments to workers employed near the border, and cash seized from criminals.

- Finally, the decline in correspondent relationships impedes access to secure remittance transactions from the U.S. to Mexico for low-income people with marginal access to banking.

Despite Mexican banks and the Mexican government implementing AML/CFT controls and practices that generally meet international standards and requirements, regulatory scrutiny of cross-border financial services continues to disrupt trade and flows of foreign direct investment and some remittance transactions, imposing significant economic costs.

Anti-Money Laundering Regulation, Correspondent Banking, and the Adverse Economic Effects for the U.S.-Mexico Bilateral Relationship

Robert Shapiro *with* Isaac Yoder[1]

I. INTRODUCTION AND SUMMARY OF FINDINGS

The economies of the United States and Mexico are extensively interconnected through billions of dollars foreign direct investments, trade flows and remittance transfers. American and Mexican companies are active investors in each other's economies: In 2020, Mexico received more than $12 billion in U.S. foreign direct investments (FDI), and Mexican FDI flows to the United States totaled nearly $2 billion.[2] In 2020, the stock of Mexican FDI in the United States totaled nearly $21 billion while the stock of U.S. FDI in Mexico was more than $101 billion.[3] The United States and Mexico also are major trading partners. In 2019, Mexico imported $307 billion in goods and services from the United States and exported $398 billion in goods and services to the United States, trade flows equivalent to 3.3 percent of U.S. GDP and a remarkable 56.0 percent of Mexico's GDP.[4] In addition, remittances or direct money transfers from abroad to people in Mexico totaled $51.6 billion in 2021, including $49.0 billion from U.S. residents.[5]

These extensive economic ties between Mexico and the United States involve hundreds of thousands of daily transfers of funds between financial institutions in the two countries, principally through correspondent banking relationships. Correspondent banking has been an essential part of the organization and practice of international commerce and finance for more than a century, under arrangements in which banks in different countries maintain accounts with each other and act as intermediaries or agents to service payments and transfers originating in one country and concluding in the other country. These transactions may involve the correspondent banks' own clients and customers, or a correspondent bank may act as a third party to facilitate transactions for clients and customers of other financial institutions. Nearly all correspondent banking transactions involve electronic transfers, although a modest share involve bulk foreign currencies collected from payments by tourists, residents working near borders, proceeds from criminal activities seized by authorities, and a small share of remittances.[6] These bulk transfers of U.S. dollars from Mexican banks to U.S. institutions totaled $6.3 billion in 2021.

Over the past decade, correspondent banking has been subject to strict regulatory requirements and oversight in many countries, including the United States and Mexico, based on international concerns about criminal organizations using the arrangements to launder funds and finance terrorism and other criminal activities across countries. Concerns about money laundering are well-based: Estimates by the United Nations and the World Bank of the volume of funds laundered in 2021 range from $800 billion to more than $3 trillion.[7] However, evidence and analysis indicate that focusing U.S. anti-money laundering (AML) efforts and steps to combat terrorist financing (CTF) on correspondent banking, particularly between the United States and Mexico, has become ineffective, misplaced, and economically harmful.

The Money Laundering Act of 1986 was the first U.S. legislation that specifically criminalized the act of using proceeds from criminal activity in any financial transaction with an intent to conceal the source, ownership, or control of those proceeds, and the G-7 countries created the Financial Action Task Force (FATF) in 1989 to develop internationally accepted laws and strategies for fighting money laundering.[8] These international efforts to stem money laundering accelerated after the 9/11 attacks, when the Patriot Act directed that a wide range of financial institutions take steps necessary to "Know Your Customer" (KYC) by verifying the identity of anyone who deposits funds, owns a business opening an account, directs a foreign entity opening an account, or transfers $10,000 or more.[9] Amendments to the Bank Secrecy Act in 2016 extended the KYC requirements to "beneficial owners" of new accounts, covering anyone with a 25 percent interest or more in an account's assets or a company opening an account.[10]

Correspondent banking has been an essential part of the organization and practice of international commerce and finance for more than a century, under arrangements in which banks in different countries maintain accounts with each other and act as intermediaries or agents to service payments and transfers originating in one country and concluding in the other country.

These approaches have especially targeted correspondent banking: The laws specifically direct that KYC requirements be applied to any person or entity with a correspondent account in the United States for a non-U.S. person or entity, bar correspondent accounts for foreign banks without a U.S. presence, and direct banks to apply special due diligence to foreign banks and clients. They also grant the U.S. Treasury authority to demand the records of any correspondent account, closedown any correspondent account, designate any foreign bank in a correspondent banking relationship as a "money laundering concern," and exclude it from carrying out international capital flows.[11]

This approach has proved to be inefficient. There are no official statistics on AML/CTF enforcement, but one commentator estimates that more than 90 percent of laundered funds are undetected,[12] and others have estimated that AML/CFT enforcement manages to seize 0.1 percent to 0.2 percent of laundered funds.[13] As we will see, one reason is that criminals responded to the focus on correspondent banking by adopting stratagems that frustrate or avoid those regulatory efforts to oversee them for AML and CFT purposes. Criminals routinely endeavor to thwart attempts to be identified as ultimate owners or beneficiaries by using bogus identity documents and secreting their funds through tiers of legally incorporated and licensed shell companies, trusts, and foundations that cross many jurisdictions. These entities also employ "nominee" directors and officers with no link to or knowledge of the ultimate owners and beneficiaries, and those sham directors and officers can issue anonymous bearer shares ultimately transferred to the actual owner or beneficiary.

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Sophisticated money launderers also regularly bypass banking systems altogether by using "shadow banking" arrangements such as direct internet-based transfers, blockchain-based cryptocurrency payments, complex financial derivatives, and serial equity crowdfunding of sham projects. Drug cartels, terrorist groups and other money launderers also use "Informal Value Transfer Systems" to move funds anonymously through networks of intermediaries outside formal banking systems. These non-bank networks include currency exchanges, stock brokerage accounts, casinos, auto dealerships, insurance trading companies, gems and precious metals, internet banking, and wire transfers that evade AML/CTF requirements and enforcement focused on banks and correspondent accounts.

The particular emphasis of U.S. AML/CFT regulation and enforcement on correspondent banking transfers between the United States and Mexico also is misplaced. For more than a decade, Mexican government and banking institutions have taken substantial and broadly successful steps that have sharply reduced the risk of money launderers using the nation's banks and correspondent banking arrangements. In 2018, IMF reported that Mexico had established a "mature" AML/CTF system based on a well-developed legal and institutional framework, including systems for real time monitoring of settlement payments, enforcement of identification standards, and cross-border information sharing.[14] The World Bank also commended Mexico's system of databases and monitoring of wire transfers in foreign currencies and cross-border transfers originating in Mexico and abroad.[15] The main caveat noted by these international bodies regarding Mexico involved enforcement related to non-banking institutions.

Other international bodies also have noted the effectiveness of Mexico's current AML/CFT protocols and operations, especially compared to other countries. The Basel Institute on Governance (BIG) evaluated country efforts to discourage and discover laundered funds based on compliance with FATF recommendations and goals and on regulators' ability to pierce bank secrecy.[16] Its evaluation of Mexico in 2021 found that the country's efforts to prevent money laundering and terrorist financing were superior to those in 60 other countries, ranging from Cayman Islands, Thailand, and the Philippines to Russia, Saudi Arabia, and Hong Kong.

Similarly, the Tax Justice Network (TJN) conducted intensive analysis of cross-border financial transactions and secrecy covering 133 countries, including legal provisions for secrecy in banking transactions and their administration.[17] The TJN analysis for 2020 found that Mexican banking was more transparent than banking in 109 other countries, including the United States, Japan, Canada, and Israel.[18] The analysis also assessed the likelihood of

...Mexican government and banking institutions have taken substantial and broadly successful steps that have sharply reduced the risk of money launderers using the nation's banks and correspondent banking arrangements. In 2018, IMF reported that Mexico had established a "mature" AML/CTF system based on a well-developed legal and institutional framework, including systems for real time monitoring of settlement payments, enforcement of identification standards, and cross-border information sharing.

laundered money flowing through each country by measuring the extent of cross-border financial flows involving financial institutions in each country. TJN reported that Mexican banks were involved in less than one-tenth of one percent (0.09 percent) of all international payments and transfers and that 47 countries handled larger shares of those transactions than Mexico. The much larger players in cross-border payments and transfers included Ireland, Hong Kong, Switzerland, France, and Japan with 25 to 50 times as many transactions as Mexican financial institutions; Singapore, the Cayman Islands, and Germany with 50 to 100 times as many such transactions; and Luxembourg, the United Kingdom, and the United States with 137 to 237 times as many transactions as Mexican institutions.

Targeting AML/CFT regulatory efforts on financial transactions between the United States and Mexico is inefficient, given Mexico's status as a very minor factor in cross-border financial flows as well as the robust state of its AML/CFT arrangements and practices. These regulatory efforts also could produce greater results by targeting non-banking entities and the tiers of anonymous sham companies, trusts and foundations located across nations, as such entities have displaced correspondent banking relationships and banking generally as unwitting or occasionally deliberate facilitators of money laundering and terrorist financing.

The current U.S. regime of AML/CFT regulation of correspondent banking between the United States and Mexico also has become economically costly by making transfers between U.S. and Mexican institutions more difficult, time-consuming, and expensive. For many banks, the continuing regulatory focus on correspondent banking transactions also has raised a prospect of serious financial penalties and reputational damage if, for example, regulators charge that a bank failed to penetrate a network of shell entities laundering funds. Banks that maintain their correspondent banking arrangements also invite broader scrutiny by banking regulators, further increasing their operating costs compared to competitors. Many banks have responded to these developments by eliminating their correspondent banking operations or limiting them to important long-time customers and clients. This "de-risking" process has further increased the costs of cross-border payments and transfers for companies and individuals.

Since the volume of the financial transactions associated with foreign direct investments, trade, and remittances between the United States and Mexico is very large, this de-risking process has had adverse economic effects. To assess those effects, we analyzed the extent of the decline in correspondent banking relationships across many countries, including Mexico and the United States. The Bank of International Settlements reports that the number of active correspondents declined 30.5 percent across Latin America and by 12.2 percent in North America.[19] Worldwide, the number of active correspondents declined 25 percent since 2011 (a notable exception is the sharp rise in correspondent banking relationships involving China).[20] This de-risking has especially impaired correspondent banking relationships involving smaller banks, which declined 34 percent in Mexico. The value of correspondent banking transactions involving Mexico also declined 8.2 percent despite the country's extensive AML/CFT reforms and compliance and even as the value of those transactions increased in Brazil, Argentina, Chile, and Panama.

...reductions in correspondent banking are associated with a slowdown in annual FDI flows between the United States and Mexico in both directions.

Next, we applied econometric analysis to assess whether these effects on correspondent banking involving Mexico affected trade volumes and flows of foreign direct investments and remittances. To do so, we analyzed changes in those payments and transfers involving Mexico as compared to countries in which correspondent banking did not contract to comparable degrees. We found that the regulatory focus on correspondent banking transactions between the United States and Mexico is associated with significant adverse effects on foreign direct investment and trade between the two countries.

Foreign direct investment, especially from companies in advanced economies such as the United States to developing economies such as Mexico, is highly significant economically. FDI involves creating joint ventures with local companies in other countries or establishing foreign affiliates or subsidiaries in other countries; and these new operations typically include transfers of not only technologies but also management skills and operational knowledge that local companies can emulate and replicate.[21] FDI-based enterprises also stimulate new business for local firms that produce goods and services for the new enterprises. Further, these features of FDI-based modernization generate local income and so support employment, government revenues and growth in a developing economy such as Mexico.

FDI funding from the United States to Mexico and the repatriation of associated profits from Mexico to the United States all flow through banks in the two countries, and much of those flows have involved correspondent relationships. We should expect that the misplaced regulatory oversight of correspondent banking linked to AML/CFT efforts could adversely affect legitimate FDI-related flows between the United States and Mexico.

Our analysis found that the reductions in correspondent banking are associated with a slowdown in annual FDI flows between the United States and Mexico in both directions: These effects reduced Mexican FDI flows to the United States by an estimated $477 million per-year from 2012 to 2018 and reduced the estimated stock of FDI in the United States in a given year by nearly an estimated $3.3 billion. The effects on U.S. FDI to Mexico also were significant: The decline in correspondent banking was associated with an estimated $1.4 billion average reduction in the U.S. stock of FDI in Mexico in a given year from 2012 to 2018.

The slowdown in Mexican FDI to the United States has meaningful economic effects. Our analysis found that it dampened U.S. GDP growth by an estimated 0.03 percent per-year from 2012 to 2018, for an estimated cumulative loss of $38.3 billion or $5.5 billion per-year.

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$38.3 billion or $5.5 billion/year.

The analysis also found that this impact dampened U.S. employment growth by an estimated 285,100 positions over those years or an average of 40,730 jobs per-year.

The analysis also showed that the decline in correspondent banking relationships associated with misplaced AML/CFT efforts reduced Mexican exports to the United States by $74.3 billion over the decade from 2011 to 2021 compared to what would have been expected without the changes in correspondent banking. These adverse effects also are economically significant because a slowdown in trade flows also directly affects employment: The reduction in Mexican exports associated with the reduction in correspondent banking dampened U.S. employment growth by an estimated 113,830 jobs from 2011 to 2021.

Correspondent banking arrangements also are significant channels for remittances from the United States to Mexico. Mexico receives the fourth largest inflows of remittances in the world behind India, China and the Philippines and five times the global average as a share of GDP.[22] As noted, Mexican households received $51.6 billion in remittances in 2021, of which $49.0 billion or 95 percent came from the United States. Those remittances represent either the main source or an important source of income for more than 60 percent of the Mexican households receiving them.[23] While money launderers rarely use

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remittances to transfer criminal funds, many financial institutions in Mexico and the United States have withdrawn the service over the past decade as part of the de-risking strategies associated with AML/CFT regulatory scrutiny. The value of U.S. remittances to Mexico continued to rise as U.S. employment grew and immigrants became more skilled with age and education; but the transparent and once competitive market for remittance transactions has become much more concentrated, reducing access and shifting more transfers to less reliable and sometimes more costly informal channels. As a result, the current regulatory focus on correspondent banking harms lower-income people in both countries.

II. THE IMPACT OF AML/CFT REGULATION ON CORRESPONDENT BANKING

Statutory Basis for AML/CFT Regulation

Government efforts to detect and deter money laundering have long focused on the banking system, since criminal proceeds accepted by a bank can be transferred easily for any purpose. The underlying statute in the United States is the Bank Secrecy Act (BSA) of 1970, which directed financial institutions to help detect and deter money laundering by keeping records of cash purchases of negotiable instruments and reporting transactions exceeding $10,000.[24] The Money Laundering Act of 1986 followed as an amendment to the BSA, prohibiting anyone from using the proceeds from specified crimes in any financial transaction with the intent of concealing its sources, ownership, or control.[25] Following the 9/11 attacks, efforts to detect and deter money laundering intensified around concerns about terrorist financing. The Patriot Act passed in October 2001 further amended the BSA by directing banks, thrifts, credit unions and other federally regulated financial entities to identify criminal proceeds through requirements to "Know Your Customer" (KYC).[26] The most recent amendment to BSA passed in January 2021 created an "ultimate beneficial ownership" register to help detect money laundering through shell entities.

The KYC or "Customer Due Diligence" requirements are designed to help ensure that banks understand the nature and purpose of their relationships with their customers, including the types of transactions that involve them. These requirements comprise one of five "pillars of compliance" under the BSA.[27] The other four elements direct banks to 1) designate an officer with the resources, independence, and qualifications to administer the bank's AML/CFT compliance program; 2) establish and implement a system of internal controls to ensure that all AML/CFT regulatory requirements are satisfied; 3) provide AML/CFT training tailored to the roles of each employee on an annual basis; and 4) conduct regular independent audits of audits. These five pillars provide a reasonable framework to regulate correspondent banking relationships and address money laundering, especially insofar as it occurs through those relationships.

The Regulatory Focus on Correspondent Banking

As noted, the KYC efforts established under the Patriot Act focus particularly on correspondent banking operations by specifically directing banks to apply KYC requirements to any person or entity maintaining a correspondent account in the United States for a non-U.S. person or entity and barring correspondent accounts for foreign banks without a U.S. presence. The Act also direct banks to apply special due diligence to any foreign bank or client and grants the Treasury authority to demand the records of any correspondent account, close any correspondent account, and designate a foreign bank as a "money laundering concern" to signal U.S. banks to stop dealing with it.[28]

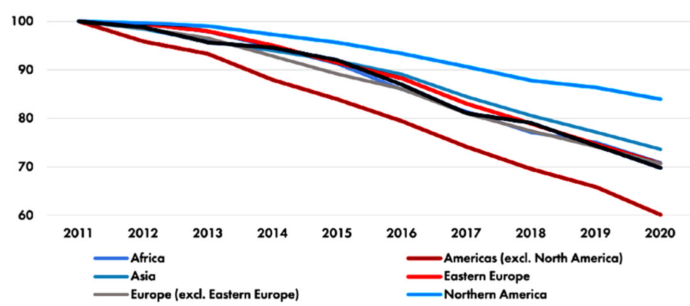
The focus on foreign banks and clients reflects the fact that a large share of money laundering involves cross-border transactions. The specific focus on the trade financing conducted through correspondent banking reflected a view that those cross-border financial flows accounted for a significant share of money laundering. As we will see, money launderers responded by creating networks of shell or sham companies, trusts and foundations that superseded correspondent accounts and other forms of trade finance and by migrating from banks to non-regulated or informal financial entities.

The focus of AML/CFT laws and enforcement on correspondent banking also led many banks to curtail their cross-border correspondent banking operations and thereby reduce the risk of unknowingly facilitating money laundering that could lead to fines and reputational damage and attract more general attention from bank regulators. This de-risking process began initially as a response to evidence that drug cartels were moving large amounts of illicit money through banking systems. A decade later, some countries that had been high or significant risk environments for money laundering, including Mexico, had developed much more effective AML/CFT compliance regimes—and much money laundering had migrated away from direct transactions involving banks. Nevertheless, correspondent banking remains a focus of much AML/CFT operations, and the de-risking process has continued.

This de-risking of correspondent banking relationships affects every region in the world (see Figure 1, below). Overall, the numbers of active correspondents declined by about 25 percent from 2011 to 2020, with one notable exception: Correspondent banking relationships involving Chinese banks increased by a remarkable 3,355 percent from 2009 to 2016.[29]

FIGURE 1:

Percentage Decline in Active Correspondents by Region, 2011-2020



This de-risking has especially disadvantaged smaller banks. Large financial institutions have withdrawn or declined correspondent bank relationships with smaller regional banks, a development evident in correspondent banking between U.S. and Mexican banks. Smaller banks also are disadvantaged by the high costs of complying with AML/CFT regulation and dealing with its regulators, costs borne more easily by large international institutions. For example, JP Morgan Chase employs 9,000 people on AML/CFT matters, and Western Union spends $200 million annually monitoring suspicious activity.[30] High compliance costs have forced many smaller financial entities to curtail or end providing services such as trade finance, business payments to foreign suppliers abroad, and family remittance transactions. Accordingly, correspondent banking relationships involving local and regional Mexican banks declined 34 percent; and by 2016, only 23 of 53 Mexican banks surveyed maintained correspondent banking operations.[31] As a result, the U.S-Mexican banking sector in this area has consolidated around a limited number of institutions; and compared to other Latin American economies of similar size, access to cross-border payments has been disproportionately restricted in Mexico.[32]

Correspondent banking relationships also declined worldwide from 2011 to 2020 with the largest declines in active correspondents affecting the smaller economies in Latin America, Africa, Southern Asia, and the Pacific. This decline was less severe in Mexico than in some other Latin American and Caribbean countries; but the value of correspondent banking transactions involving Mexico fell 8.2 percent while increasing substantially in 18 other Latin American countries, including other large nations in the region such as Brazil, Argentina, Chile, and Panama. The only Latin American countries that experienced larger declines than Mexico in the value of those transactions were Venezuela, Cuba, Belize, Barbados, the Bahamas, and Bolivia.

As we will see, this de-risking proceeded despite major reforms by the Mexican government to address AML/CFT concerns, including changes in Mexican law to conform to standards put in place by the international Financial Action Task Force, revisions in bank secrecy requirements to provide more transparency around AML/CFT, improvements in monitoring banking transactions, and allowing domestic banks to share client information with international correspondent banks registered with the Ministry of Finance.[33] Since Mexican banks use correspondent relationships to transfers bulk dollars back to the United States, and cash poses a larger threats of being associated with money laundering, Mexico also established strict limits on domestic banking operations involving foreign cash and reporting requirements for cross-border transfers of bulk cash and procedures for foreign authorities to validate the reports.[34]

The Mexican government and financial institutions also established new databases to monitor cross-border financial transactions through domestic banks, including the customer, beneficiary, recipient bank, and amount sent for every financial transaction crossing Mexico's borders.[35] Mexican authorities also put in place a KYC utility to record the identity users and clients involved in cross-border and domestic wire-transfers. Further, Mexico developed new mechanisms to offset in part the declining availability of U.S. correspondent banks, such as an interbank settlement system created by its central bank that uses U.S. dollars for local interbank transfers.[36] By 2017, the IMF reported that Mexico had established a "mature AML/CFT regime, with a correspondingly well-developed legal and institutional framework."[37]

Despite Mexico's anti-money laundering reforms and compliance systems, the decline in correspondent banking services continued. The cumulative value of correspondent banking payments in Mexico fell 15.1 percent from 2011 to 2016 and 8.2 percent from 2011 to 2020. Further, the number of foreign correspondents per domestic bank in Mexico declined 34 percent from 2011 to 2020, nearly three times than the average decline for similar-size economies.[38] Mexico's cross-border financial services market remains disrupted and underserved, impairing cross-border payments in trade and foreign direct investment as well as remittances and financial inclusion.

TABLE 1:

Changes in Correspondent Banking in Mexico and the United States, 2011-2020

	VOLUME	VALUE	CORRESPONDENT BANKING RELATIONSHIPS
Mexico	22.2%	- 8.2%	- 20.0%
U.S.	41.9%	59.7%	- 9.8%

III. REGULATION OF MONEY LAUNDERING / TERRORIST FINANCING AND CORRESPONDENT BANKING

Money laundering of all types involves tactics and strategies to hide an underlying crime and spend the proceeds from those crimes or use those proceeds to facilitate new crimes such as terrorism or tax evasion. Therefore, money laundering necessarily involves hiding the origins of funds from law enforcement.[39] For decades, money laundering typically involved criminals convincing banks to accept those proceeds while obscuring their illegal origins and actual ownership. Analysts often describe the process of money laundering process in three stages: 1) "Placement" or moving funds directly associated with criminal activity to an entity that handles them, notably banks; 2) "Layering" or disguising the trail from the funds to their owners using surrogates and shell entities; and 3) "Integration" or ensuring that the funds are available to their criminal owners through seemingly legitimate sources using false invoicing, loans, and other financial operations or purchases of legal assets such as stock or real estate.[40]

As noted, a central tool of AML/CFT efforts is the Know Your Customer (KYC) requirements.[41] KYC regulations direct that all banks and other federally chartered financial institutions confirm the identity of anyone depositing funds, the owners of any business opening an account, the identities of the officers and directors of foreign companies opening an account, and the identity of people or entities transferring $10,000 or more. Under those regulations, individuals must provide their names, addresses, tax ID numbers and birthdates and must confirm the information by providing notarized proof such as a driver's license and/or a verified social security number. Under the Bank Secrecy Act of 2016, all federally-regulated banks and credit unions, mutual funds, brokers and dealers, and commodity brokers are also required to identify the "beneficial owners" of any new account—anyone with a 25 percent or more interest in the assets of in an account or a company opening an account,[42] although trusts are exempted from that requirement.[43]

As we will see, while reliance on KYC regulation has focused especially on correspondent banking, criminal and terrorist organizations have shifted their strategies for laundering funds, largely forsaking correspondent banking relationships and often avoiding banks entirely. As a result, extensive research shows that criminals now routinely evade efforts to slow money laundering through KYC regulation of banks' correspondent banking relationships.

The Dimensions of Money Laundering

One reason for the failure of current anti-money laundering strategies is the sheer volume of funds being laundered. Estimates of the extent of money laundering, most of it through sham entities and non-banking channels, have ranged from $600 billion to more than $3 trillion per-year, with most experts at the upper-end.[44] The World Bank estimates that between 2.0 percent and 5.0 percent of global GDP is laundered annually, which suggests a range of $3.3 trillion to $6.2 trillion in 2021.[45] The United Nations is more conservative, calculating that laundered funds worldwide totaled $800 billion to $2 trillion in 2021.[46] Efforts to detect money laundering through banking institutions also face the daunting volume of deposits and bank accounts: In 2021, weekly deposits in some 600 million accounts held in U.S. commercial banks averaged $17.2 trillion.[47]

There is no central entity that collects and analyzes information about possible money laundering and then organizes and coordinates responses. In the United States, responsibilities for detecting laundered funds and enforcing anti-money laundering laws are divided among at least nine national agencies—in addition to the Financial Crimes Enforcement Network (FinCEN) and the Office of the Comptroller of the Currency (OCC) in the Treasury Department, the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve, the Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), the National Credit Union Administration (NCUA) and the Federal Bureau of Investigation (FBI) also are involved, as well as hundreds of state and local bank regulators and law enforcement agencies.[48]

Since most money laundering requires cross-border transfers, hundreds of agencies in other advanced and developing countries also collect information and try to enforce anti-money laundering laws. The multilateral organizations focused on money laundering, notably the Financial Action Task Force (FATF) and the Global Organization of Parliamentarians Against Corruption (GOPAC), have created standards for anti-money laundering legislation and practices. They also advise governments and other multilateral institutions that similarly monitor the problem, such as the World Bank, the International Monetary Fund (IMF), the U.N. Office on Drugs and Crime (UNODC), Interpol, the Egmont Group, and Transparency International. However, coordination across countries remains difficult. While estimates of the volume of laundered funds are imprecise, experts believe that anti-money laundering operations detect in some way less than 10 percent of laundered funds worldwide and seize a fraction of one percent of all laundered funds.[49]

Weaknesses in Current Approaches

Criminals have no difficulty acquiring fake driver's licenses and social security numbers to establish identification or in securing incorporation and licensing papers for sham, shell companies. When criminal organizations successfully use banks to launder funds, they also have routinely used proxies to establish the accounts and deposit, transfer, and receive the criminal proceeds. Those proxies may appear to be reputable. In recent years, attorneys, clergy, real estate agents and investors, as well as personnel from banks such as Lloyds Bank and the Bank of New York, have been convicted for depositing or receiving funds on behalf of criminal organizations through sham bank accounts and shell companies.[50]

Over the last decade, the internet also has become a prominent new source of false identities acquired through data breeches and used to create fake profiles that open accounts and, as needed, launder funds by initiating and receiving transfers from shell companies, trusts and foundations or by purchasing and selling worthless equity in sham entities.[51] Sophisticated criminal organizations regularly create elaborate networks of those shell entities across many national jurisdictions to deposit, transfer and receive funds that become virtually untraceable. The Panama and Pandora Papers revealed tens of thousands of such shell companies established across the world to separate particular individuals or entities from the ownership of assets and thereby obscure the origins of very large amounts of money. On behalf of a Columbian drug cartel, for example, law firms and other financial services providers established more than 100 sham bank accounts in 68 countries that routed funds from the cartel through a series of European, Latin American and U.S. shell entities.[52]

To fulfill KYC requirements, these sham entities also often employ "nominee" directors and officers with no actual connection to the business or operations of the shell company, trust, or foundation. The financial services firms that create, incorporate, register, and license shell entities in places that require little documentation of ownership and protect the identities of clients—such as Panama, Hong Kong, and the Cayman Islands—often provide the nominee directors and officers that can authorize deposits, transfers, and receipts of funds from illegal activities. A study of companies providing these services found that more than one-third required no documentation of an owner's identity, including firms located in the United States, the United Kingdom, Spain, and Canada, and that some of them also set up bank accounts for the sham entities.[53] Similarly, in cases of tax evasion, nominee directors and officers can deposit, transfer, and receive funds that an owner wishes to hide from tax authorities. A survey of British financial institutions subject to KYC requirements under FATF agreements found that nearly two-thirds of bankers questioned their adequacy for AML/CFT purposes.[54]

Money launderers also can use one shell entity to pay another for "advice" and then repatriate the money through sham loans or consultancy work.[55] The officers and directors of these entities can authorize and secure issues of "bearer shares" so their assets can be claimed without identification.[56] Sophisticated money laundering operations also may use complex financial derivatives such as swaps involving OTC stocks carried out through an offshore company controlled by a money launderer, an approach also used by some multinational companies to shift profits from high-tax to low-tax countries.[57] Such financial maneuverings are carried out by professionals and established financial institutions, and the transactions are too complex for anyone but a small group of financial professionals to understand. As one expert in money laundering noted, "...launderers abuse a variety of financial products of different complexity, with the largest amounts being laundered through the more complex products as part of schemes that are much more difficult to detect."[58] As AML/CFT regulation and the associated reforms put in place by Mexican financial institutions have hindered the ability of criminals to exploit traditional banking channels, money laundering has largely migrated to other channels and mechanisms, including cryptocurrencies, non-banking internet transactions, the use of complex financial instruments and sham entities, and informal non-banking channels.

Following the financial crisis of 2008-2009, efforts increased to reduce some obvious weaknesses in AML/CFT enforcement, especially regarding jurisdictions that protect bank secrecy without particular regard to the identity of depositors or beneficial owners of accounts. The G20 urged those bank and tax havens to agree to treaties requiring information exchanges and threatened economic sanctions if they declined. The major bank and tax havens agreed to sign more than 300 such treaties, but with limited effect.[59] Since many haven countries did not sign treaties with every other country, funds shifted to places that remained outside the treaties. And even when treaties are in place, experts have found that actual exchanges of information have remained fairly rare.[60]

Diligent and intensive investigation by banks have uncovered some subterfuges. In most cases, however, laundered funds are only discovered when a government has indicted a criminal and investigators have traced payments to or by the criminal through a bank. Over the last decade, this approach has resulted in large fines for financial institutions that allegedly facilitated the laundering of substantial sums, including ABN-Amro, Barclays, Credit Suisse, Deutsche Bank, HSBC, ING, Lloyds, Wachovia, American Express, and the Vatican bank.[61] By one estimate, banks and other financial institutions were fined $4 billion for KYC violations in 2021.[62]

De-risking

These dynamics also have resulted in banks undertaking a singular form of de-risking focused on their correspondent banking relationships. Again, since correspondent banking has been a principal way to transfer funds across borders in commerce and finance for more than a century, AML/CTF regulation and enforcement targeted correspondent banking arrangements principally through KYC requirements. However, those requirements have become very difficult to meet in ways that ensure that criminals do not use a bank to launder funds. As a result, banks holding accounts linked to people arrested for other crimes have been subject to large fines and the reputational damage from being publicly associated with high-profile criminals.

Beyond those costs, banking institutions also are subject to a wide array of other detailed regulations enforced by the same or related agencies responsible for AML/CFT oversight.

Yet, even as criminals adopted stratagems undetectable through KYC regulation or migrated to non-banking channels, AML/CFT regulation has continued to focus substantially on correspondent banking relationships. The economic logic for many banks became clear: Reduce the risks of incurring large fines and reputational damage for violations that they could not detect and attracting the attention of regulators in other areas by cutting back on their correspondent banking operations.

The Role of Shadow Banking

In addition to the extensive use of false identities and networks of sham entities, money launderers also increasingly elude AML/CFT regulation and enforcement by using "shadow banking" arrangements that do not involve the initial placements of cash in banks. Internet and mobile payment services, electronic transfers on the internet, web peer-to-peer lending services, and prepaid cards all do not require bank accounts, accept virtual as well as regular currency, and generally are not covered by anti-money laundering regulation.[63] Criminals organizations also have been known to use internet-based equity crowdfunding to make payments without public reporting. While new money laundering regulation now formally covers this approach, serial crowdfunding for sham projects operates in much the same way and remains outside the regulations.[64] All of these forms of transfers leave electronic trails, but their enormous volume makes it hard for law enforcement to identify those used by criminals. Anti-money laundering enforcement directed to banks and their correspondent banking operations are also useless when criminal organizations access informal banking arrangements that transfer funds through human intermediaries outside the banking system.[65]

Blockchain technologies that ensure anonymity also have been adapted for money laundering as well as remittances. For example, mobile phone-based blockchain platforms such as Clolins.ph with more than 300 million customers in Southeast Asia have been established recently to expedite transfers outside formal banks.[66] While Clorins.ph is formally regulated by the Philippine government, its blockchain provides peer-to-peer transfers through digital keys that entail no personal identification information.

Cash real estate purchases to move illegal funds to legitimate channels also fall outside the purview of most money laundering regulation. The Patriot Act initially covered real estate agents, brokers, developers, lawyers, and accountants involved in real estate sales, but the Treasury exempted the sector with narrow exceptions:[67] Under current regulation, title insurance companies must identify the "beneficial owners" of cash real estate purchases for $300,000 or more in nine U.S. counties, including those containing Los Angeles and San Francisco, Miami and Palm Beach, Honolulu, New York City, Boston, Dallas, and Chicago.[68] However, sophisticated criminals buying and selling real estate for cash can get around those identification requirements by using tiers of foreign-based shell companies and/or funds held by law firms in "pooled accounts" whose owners are protected by lawyer-client privilege.[69] Evidence suggests that real estate now plays a distinct role in money laundering: Some 62 percent of real estate purchases by foreign entities or individuals in the mid-2010s were cash transactions,[70] and FinCEN reports that 30 percent of real estate transactions in which beneficial owners paid or received cash were later identified as "suspicious."[71]

Terrorist Financing

Terrorist-related funds account for a small share of money laundering—by one estimate, Al Qaeda subsisted on $30 million to $50 million per-year before Osama BinLaden's capture and death.[72] However, the Panama Papers and Paradise Papers documented the extent to which terrorist financing depends on networks of anonymous shell companies created in offshore financial centers and tax havens to hide and move their illicit funds.[73] Along with other criminal organizations and tax evaders, terrorist networks also use sham charities, sham trusts and sham foundations as well as shell corporations, located usually in countries with weak anti-money laundering laws or enforcement.

Terrorist groups also are prominent users of "Informal Value Transfer Systems" outside the traditional banking system to shift funds anonymously through networks of intermediaries. These non-bank or shadow bank networks use a range of approaches and entities, including currency exchanges, stock brokerage accounts, casinos, auto dealerships, insurance trading companies, gems and precious metals, internet banking, and wire transfers.[74] Terrorist organizations and other money launderers in the Middle East have favored "hawala" arrangements also used by millions of people who work abroad, earn money legally, and want to send funds home at low costs. [75] Hawala is a type of shadow or underground banking that operates openly and provides a way to transfer funds based on personal trust between Hawala dealers rather than the guarantees of entities regulated by governments.[76] A person using hawala to transfer money from Dubai to a person in Karachi—for legitimate purposes or to launder the funds—gives cash to a dealer in Dubai, who gives the payor a code and communicates the amount and recipient's name to a trusted dealer in Karachi who pays the designated recipient when he provides the code for verification.

Hawala transfers can occur without the payer or recipient providing any formal identification, and hawala dealers have no records of those payers and recipients. In some cases, two hawala dealers also may be partners in a legitimate business such as an import-export company and use the funds to clear debts between themselves by under-invoicing or over-invoicing for a recent or subsequent shipment.

"White" hawala, used for legitimate remittances, is less expensive and quicker than bank wire transfers, and several such informal transfer networks are also located in Asia, including Fei ch'ien in China, Phoe Khan in Thailand, and Door-to-Door in the Philippines.[77] "Black" hawala involves illegal funds transferred by terrorist and other criminal organizations, often involving a series of dealers across several countries and sometimes entailing payouts in gold or investing the transferred funds in legitimate businesses to complete the money laundering process.

Based on these and other developments described earlier, the role of banks in terrorist financing and other money laundering, and the particular role of correspondent banking relationships, have diminished greatly.

IV. MEXICO AS A FOCUS OF U.S. AND INTERNATIONAL AML/CFT EFFORTS

Among the billions of financial transfers and payments between Mexico and the United States, some certainly involve funds being laundered. However, the likelihood of criminal organizations doing so by using correspondent banking between the two countries has become very small. As noted above, money laundering and terrorist financing have substantially migrated to non-banking channels including cryptocurrency exchanges, real estate transactions, and money transfer arrangements outside banking systems, as well as transfers through multi-tier networks of shell companies, trusts and foundations that do not involve correspondent relationships. The *Financial Times* has noted, "the crackdown on money laundering has not necessarily curtailed the practice, but instead may simply have pushed it further underground."[78] In addition, as IMF analysts reported in 2016, the burdens of the intense regulatory pressures on correspondent banks and possible sanctions have exerted significant pressure on correspondent banking relationships in Mexico, forcing many banks out of the legitimate operations of correspondent banking.[79]

The Mexican government and banking institutions also have taken aggressive measures to sharply reduce the risk of criminal and terrorist organizations using the nation's banks and accessing correspondent banking. In 2018, the IMF assessed these efforts in Mexico and concluded that "Mexico has a mature AML/CFT regime, with a correspondingly well-developed legal and institutional framework."[80] The IMF noted that Mexico has increased its AML/CFT controls by implementing monitoring systems for real time gross settlement payments system, enforcing regulations requiring banks to use Legal Entity identifier standards, and adopting cross-border information sharing between domestic banks and foreign correspondent banks. Mexico also created and maintains a centralized database to share information and identify customers in cross-border transfers.[81] Given the enhanced concerns around transfers of bulk cash and the use of correspondent relationships to transfers bulk dollars from Mexican to U.S. banks, Mexico also imposed strict customer limits on deposits and transfers involving foreign cash and strict reporting of cash transferred from Mexican to U.S. correspondent banks, with procedures for U.S. authorities to validate the reporting.[82] The World Bank has documented that Mexico also maintains and updates daily a database of domestic wire transfers in foreign currencies, cross-border transfers originating in Mexico, and transfers originating abroad, including KYC information about an ordering customer, recipient bank, beneficiary of the transfer, amount sent, and currency used.[83]

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The IMF also has attested that the Mexican government revised the nation's bank secrecy laws to support enforcement of AML/CFT regulation, and the Central Banco de Mexico has put in place a U.S. dollar credit transfer payment system for processing transfers in U.S. dollar accounts between domestic banks and Mexican firms that includes AML/CFT controls for firms and banks participating in the payment system.[84] The IMF's main criticisms of the AML/CFT efforts by Mexico involve "Designated Non-Financial Businesses and Professions" (DNFBP)—non-banking institutions using arrangements unrelated to correspondent banking.[85]

The Basel Institute on Governance (BIG) also monitors and evaluates how well 110 countries police their cross-border transfers and ranks them in the "Basel AML Index" for their efforts to discourage and discover laundered funds.[86]

The Basel Index covers both direct and indirect factors involved in money laundering and provisions to deter and punish it. The most important assessments cover each nation's compliance with 40 FATF recommendations and 11 FATF goals and the ability of AML/CFT enforcement to penetrate bank secrecy. Each country's ranking also draws on evaluations by the U.S. State Department of each country's effectiveness in tackling international drug and human trafficking and the World Bank's evaluations of each country's financial regulation and assessments of government and corporate transparency, public corruption and bribery, and the strength of the rule of law and political liberties. The 2021 Basel Index found that Mexico's efforts to prevent money laundering and terrorist financing were superior to those in 60 other countries, ranging from Cayman Islands, Thailand, and the Philippines to Russia, Saudi Arabia, and Hong Kong.

Consistent with our analysis of the inefficiency of focusing anti-AML/CTF enforcement on KYC regulation of correspondent banking relationships, the BIG 2021 analysis also highlights the growing use by money launderers and terrorist groups of non-banking strategies, the ineffectiveness of technical compliance with AML/CFT regulation, inadequate monitoring of beneficial ownership, and weak application of AML/CFT measures to non-financial entities. The 2021 Index report notes, as a "simple example,"

> *... money launderers can buy and sell properties or precious metals to help obscure the illicit origins of their money ... use corporate vehicles to disguise the true ownership and control of the funds and assets... (while) lawyers, accountants and TCSPs [trust and company service providers] are advising and assisting criminal clients with hiding and laundering illicit funds.*[87]

An important factor in Mexico's strong AML/CFT performance is the transparency of its banking transactions to AML/CFT enforcement, given that the secrecy of financial transactions is a basic element of money laundering and terrorist financing. In addition to the BIG rankings, the Tax Justice Network (TJN) conducts intensive analysis of secrecy and cross-border financial transactions covering 133 countries, including legal provisions for secrecy in banking transactions and administration. TJN publishes the results in its Financial Secrecy Index (FSI).[88] The most recent FSI findings show that financial secrecy in Mexican banking—including correspondent banking—does not significantly inhibit AML/CFT efforts in Mexico.

The FSI applies 20 standards or benchmarks to generate a "secrecy score" for each country based on how much financial secrecy it provides under its laws, regulations, and treaties.[89] Those benchmarks include evaluations of each country's bank secrecy laws, provisions to register and monitor both local and foreign trusts and foundations, provisions to establish the legal and beneficial owners of companies, including limited partnerships, and the public access to such information. The standards also cover whether companies are required to publish country-by country financial reports and whether a country bars bearer shares. Finally, a country's secrecy score also depends on the extent to which a country follows the anti-money laundering recommendations of the FATF, participates in exchanges of financial information with other countries, adopts bilateral treaties for information exchanges with at least 108 other countries, and cooperates with international agencies to detect money laundering.

TJN reported that based on those scores, Mexico is more transparent than 109 of the 133 countries and well ahead of countries such as the United States, Japan, Canada, and Israel.[90]

The FSI also analyzes global data on capital flows to evaluate the extent of each country's participation in worldwide cross-border flows of funds through its financial institutions. These findings are an important measure for allocating AML/CFT resources where they are likely to be most productive. Those data show that Mexico's banks provided less than one-tenth of one percent (0.09 percent) of all such international financial transfers and payment services, for criminal as well as legitimate purposes.[91]

All told, 47 other countries handle larger shares of those cross-border financial transactions, including 11 major players. In five countries (Ireland, Hong Kong, Switzerland, France, and Japan), financial institutions handle between 25 and 50 times as many transactions as their Mexican counterparts; and in three more countries (Singapore, the Cayman Islands and Germany) such institutions handle between 50 and 100 times as many transactions as those in Mexico. Three additional nations (Luxembourg, the United Kingdom, and the United States) are the dominant players in these international financial flows, processing nearly half of all worldwide cross-border transactions and accounting respectively for 137 times, 177 times, and 237 times as many of those transactions as Mexico's financial institutions.

Moreover, seven of the 11 major players in cross-border financial flows—Hong Kong, Switzerland, Singapore, the Cayman Islands, Luxembourg, Japan, and the United States—also are less transparent to AML/CFT regulatory efforts than Mexico. This clearly suggests that targeting AML/CFT regulation and enforcement on financial flows between the United States and those less-transparent and more important players in cross-border transactions would be much more efficient than the focusing on U.S.-Mexico transactions involving correspondent banking.

V. ECONOMIC EFFECTS OF DE-RISKING IN CORRESPONDENT BANKING

Foreign Direct Investment

Among the millions of payments and transfers flowing between the United States and Mexico, foreign direct investments (FDI) have the most far-reaching economic effects. FDI from the United States to Mexico is the principal means of introducing advanced technologies and business operations and as a result plays a critical role in Mexico's continuing economic development.[92] FDI also flows from Mexico to the United States, where it can provide technical and marketing knowhow valuable to consumers of Mexican products in the United States. These FDI transfers can involve joint ventures with local Mexican or U.S. companies or the establishment of new foreign affiliates or subsidiaries in Mexico or the United States. FDI involves transfers of advanced management skills and operational knowledge as well as technologies and marketing expertise, which local Mexican and American companies can emulate and replicate. FDI-based enterprises also can stimulate new business creation and expanded operations by existing firms to provide local goods and services for the new enterprises. These features of FDI transfers also generate local income that in turn supports jobs, growth, and government revenues.

The stock of Mexican FDI in the United States totaled $20.85 billion in 2020 ($40.1 billion by "Ultimate Beneficial Owner"), including $5.3 billion in manufacturing and $4.0 billion in agriculture and food.[93] ("Ultimate Beneficial Owner" here refers to FDI that may enter the United States from any country but is owned by Mexican person or entity, as for example, FDI by a European LLC controlled by a Mexican national or multinational company.) FDI flows from Mexico to the United States from 2016 to 2020 totaled $8.0 billion including $1.85 billion in 2020 and averaging $1.6 billion per-year.[94] Similarly, U.S. companies made $3.1 billion in foreign direct investments in Mexico in 2020, and the stock of U.S. FDI in Mexico totaled $101.1 billion, including $11.2 billion in energy and mining and $40.9 billion in manufacturing.[95]

The data do not track the share of those FDI transfers flowing through formal correspondent banking relationships. However, it is reasonable to assume that a majority of those transfers have involved correspondent banking operations: Banking institutions handle all FDI funding between the United States and Mexico as well as repatriated profits from a consequent joint ventures, affiliates, or subsidiaries;

and FDI involves long-term commitments that entail additional capital transfers by companies with ongoing business with local and foreign banking institutions.

We also should expect that the misplaced oversight of correspondent banking arising from AML/CFT efforts has affected FDI-related flows between the United States and Mexico. Studies show that multinational corporations considering FDI place considerable importance on regulatory constraints and costs,[96] and the contraction in correspondent banking activities between the United States and Mexico constrain or increase costs for companies transferring assets across borders and accessing income earned abroad. In addition, analysts have found that uncertainty adversely affects FDI flows, and the current oversight of correspondent banking between the two countries may create new uncertainties about the timing and availability of those transfers.[97]

Therefore, we should expect that the contraction in correspondent banking operations affected FDI. In the extreme case of Belize, 83 percent of its correspondent banking relationships ended from 2013 to 2016, and the IMF estimated that the worst case result of those changing conditions could dampen FDI flows equivalent to two-to-three percentage points of the country's GDP.[98] Moreover, studies have found that reductions in FDI can dampen growth, GDP and employment by reducing private capital flows, slowing the adoption of new technologies and productivity gains associated with FDI, and easing competitive pressures.[99] Analysts have found that changes in FDI also can have significant effects on a country's productivity, wages, and employment.[100]

The United States is not immune from those effects, given that Mexican FDI in the United States supported 82,600 jobs in 2020 and the stringent AML/CFT regulation of correspondent banking is expected to affect those FDI flows.[101] To estimate the impact of the contraction in correspondent banking relationships on FDI in this case, we used a "difference-in-differences" econometric approach comparing Mexico to countries in Latin America with below-median reductions in correspondent banking values (controlling for other relevant variables) and extrapolated the effects on FDI from Mexico to the United States. We also estimated the associated secondary effects on U.S. capital stock, GDP,

Mexican FDI flows to the United States were reduced by an estimated 0.31 percent or $477 million per-year, resulting in an estimated $3.3 billion reduction in the stock of Mexican FDI in the United States compared to its expected levels without the shift in correspondent banking operations.

and employment associated with the changes in correspondent banking.[102]

This modeling suggests that compared to countries with smaller shifts in correspondent banking relationships, the changes in those operations in Mexico and the United States were associated with slowdowns in FDI flows and stocks from 2012 to 2018. The analysis found that Mexican FDI flows to the United States were reduced by an estimated 0.31 percent or $477 million per-year, resulting in an estimated $3.3 billion reduction in the stock of Mexican FDI in the United States compared to its expected levels without the shift in correspondent banking operations. FDI associated with a country's companies or individuals also can enter another country through entities in third countries. Using the measure that includes these "Ultimate Beneficial Owners" (UBO), the relative reduction in FDI into the United States and linked to Mexico totals $15.7 billion over the seven-year period.

The UBO analysis suggests that this slowdown in FDI to and in the United States reduced the American economy's capital stock by an average of 0.02 percent per-year from 2012 to 2018, which in turn slowed both GDP growth and job gains by an average of 0.03 percent per-year. As a result, the impact of AML/CFT regulation of correspondent banking on FDI from Mexico to the United States was associated with slowing GDP growth by about $56 billion per-year and slowing employment gains by an estimated 40,728 jobs in a given year from 2012 to 2018.

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Trade

The importance of international trade flows to promote growth has been broadly accepted by economists for more than two centuries. Every nation has distinctive advantages and disadvantages as compared to others, and an economy is most efficient when its production draws on its relative advantages and the country relies on other economies for other goods and services. As a result, trade provides access to good and services from the most efficient sources and thereby provides lower prices and greater choice.[103] While trade is one of many factors associated with growth and its factors, analysts also have found that national income and productivity both tend to grow faster in countries with relatively larger trade sectors.[104] With regard to trade and employment, lower-price imports can result in job losses over a short-term by firms unable to compete.[105] Over a longer-term, the direct and indirect benefits of trade are associated closely with both higher employment overall[106] and with job losses in some industries competing directly with imports.[107]

The withdrawal of correspondent banking has increased the barriers to trade for the countries most effected, both by adding to the cost of cross-border transactions and by creating difficulty in accessing trade finance. One study found that banking authorities listed trade finance as the service or product affected most by the decline in correspondent banking relationships.[108] Moreover, the U.S.-Mexico trade relationship is enormous. In 2019, the United States exported $289.4 billion in goods and service to Mexico, including $96.5 billion in industrial supplies and materials and $83.9 billion in capital goods.[109] U.S. imports from Mexico in 2019 were even greater, totaling $393.1 billion including $136.2 billion in auto vehicles, parts, and engines and $106.3 billion in other capital goods.[110] These 2019 trade flows were equivalent to 3.3 percent of U.S. GDP and a remarkable 56.0 percent of Mexico's GDP.[111] According to a study from the Wilson Center, nearly 5,000,000 American jobs were related to U.S. trade with Mexico in 2016.[112]

The reduction in Mexican exports associated with the heightened regulatory burdens on correspondent banking was associated with a slowdown in job gains totaling

113,830 jobs

over the ten-year period.

To estimate the impact of AML/CFT regulation of correspondent banking on trade between the two countries, we applied an econometric approach similar to the one described above for FDI: We surveyed the export and import data for Latin American countries from 2000 to 2021 and employed a series of "difference-in-differences" estimations to model how U.S.-Mexico trade fared relative to neighboring countries with below-median reductions in correspondent banking relationships, controlling for relevant variables. The results were statistically significant for exports and showed that the impact of AML/CFT regulation on correspondent banking between the United States and Mexico was associated with a $74.3 billion reduction in U.S. imports from Mexico from 2011 to 2021 or about 2.0 percent.

This impact had consequences for U.S. employment. Based on a model of the effects of trade shocks developed by the Wilson Center and Trade Partnership,[113] the reduction in Mexican exports associated with the heightened regulatory burdens on correspondent banking was associated with a slowdown in job gains totaling 113,830 jobs over the ten-year period.

Remittances

In 2021, households in Mexico received $51.6 billion in personal remittances from abroad, of 95 percent of which originated in the United States. These remittances represented 4.0 percent of Mexico's GDP or more than five times the worldwide average,[114] and the largest recipient of remittances in Latin America. [115] (See Figures 2-A and 2-B below.) The flow of these remittances to Mexico declined during the financial crisis and rebounded with the recovery of the U.S. labor market.[116] The average cost to send remittances to Mexico fell as the flows increased, declining 22 percent from 2012 to 2015 as the value of those flows rose 12 percent.[117] However, while bank de-risking of correspondent banking activities has not slowed the volume of these remittances, it has reduced access to banking for lower-income Mexican families.

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FIGURE 2-A:

Personal Remittances as a Share of GDP: Mexico, Latin America, and the World[118]

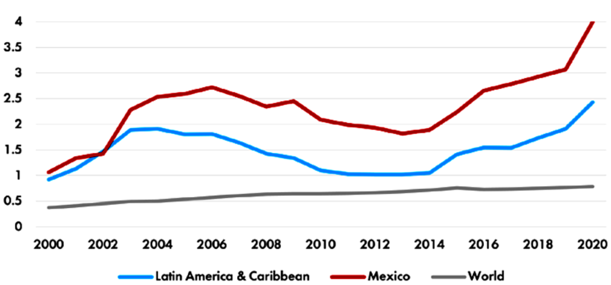
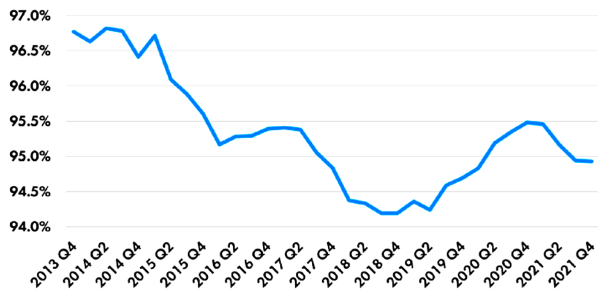


FIGURE 2-B:

Share of Mexican Remittances from the United States (Four-Quarter Moving Average)



The impact of AML/CFT regulations and enforcement scrutiny on remittance transfers has particularly burdened money transfer operators (MTOs) that depend on correspondent banks. In 2013, following the ramp-up in regulatory scrutiny of correspondent banking relationships, nearly 80 percent of surveyed MTOs reported difficulties opening correspondent banking accounts,[119] and 60 percent of local banks in Latin America reported difficulties supporting remittances in 2015.[120] As the costs associated with AML/CFT regulation increased, the competitive and transparent Mexican remittance market became concentrated in fewer banks and MTOs, creating barriers for new competitors and shifting more consumers to informal or non-banking channels.

While nearly all remittances tracked by Mexico's central bank are conducted by electronic transfer, MTOs and other non-bank institutions handle more than 77 percent of tracked remittances[121] and typically involve higher fees than banks (Figure 3 below). The World Bank calculates that the current cost to transfer and receive a $200 remittance from the United States to Mexico averages $8.79.[122] While the official data show that transaction costs have fallen as a share of the value of the remittances (Figure 3-Bbelow), some experts maintain that a significant share of remittances involve cash not captured by the central bank data.[123]

FIGURE 3-A:

Cost of Remittance Transfers from the U.S. to Mexico, Banking versus MTOs

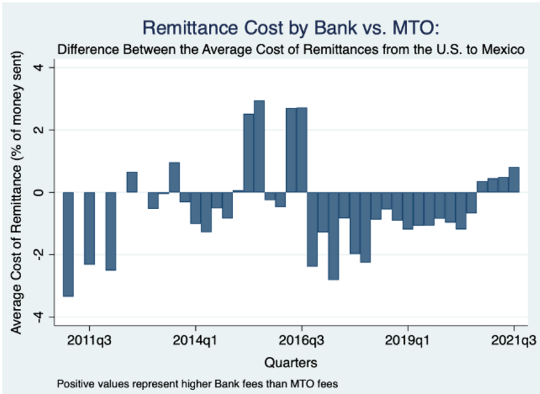
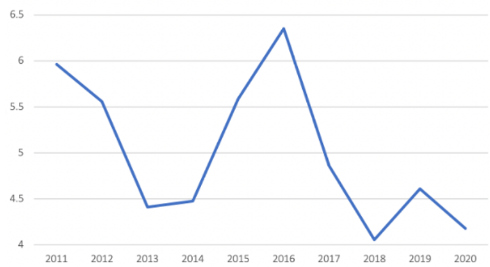


FIGURE 3-B:

Average Transaction Cost of Remittances to Mexico as a Percentage of their Value



As noted above, the withdrawal of many local and regional Mexican banks from remittance services associated with AML/CFT scrutiny has hindered efforts to expand financial inclusion among Mexican households. The World Bank reports that the share of Mexicans with bank accounts declined from 39.1 percent in 2014 to 36.9 percent in 2017, and among the 40 percent lowest-income households, that measure of financial inclusion fell from 29.4 percent to 25.8 percent.[124] By contrast, across all non-high income Latin American and Caribbean countries in those years, the share with bank accounts grew from 41.4 percent to 54.4 percent, and among the 40 percent lowest-income households, that share increased from 40.7 percent to 41.9 percent.[125]

Finally, the adverse effects from the current scrutiny of correspondent banking also include higher costs for individuals and businesses that receive foreign paper currency and other foreign cash, because Mexican banks usually use their corresponding banking relationships to transfer bulk U.S. dollars to the United States.

The central bank estimates that **$6.3 billion in U.S. currency was transferred in bulk in 2021**, half of it from tourism and the rest from payments to Mexican workers employed near the U.S.-Mexico border, "pocket remittances" carried back to Mexico by visiting migrants, and criminal proceeds seized by the Mexican government.

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The large flows of remittances from the United States to Mexico enhance Mexican GDP and growth both directly and indirectly by supporting education and by promoting investment and trade.[127] By contrast, remittances have much more modest economic effects in other Latin American countries, even those with sizable migration.[128] Finally, remittances to Mexico have beneficial distributional effects. Evidence from microdata show that lower-income Mexican households are far more likely to benefit from remittances, especially during recessionary periods: The average recipient households is in the fourth income decile, while the average household not receiving remittances is in the seventh income decline.[129]

VI. CONCLUSIONS

The United States and Mexico are extensively interconnected economically through flows of foreign direct investment, trade, and remittances. In the past, money launderers used the cross-border payment channels for those investments, trade, and money transfers, including correspondent banking relationships and operations. Much of the U.S. effort to curtail money laundering and terrorist financing consequently focused on correspondent banking.

Developments over the past decade raise serious questions about this approach. Money launderers can often evade the principal tactic, Know Your Customer regulation, through false identities and nominee officers and directors and, most important, by establishing extensive tiers of sham companies, trusts, foundations, and other entities distributed across many borders and jurisdictions. Money laundering and terrorist financing has also migrated to channels and entities outside bank regulation through internet-based exchanges, cryptocurrency operations, and informal money transfer systems around the world.

Over the past decade, the Mexican government and banking institutions have established modern systems to track transactions and comply with AML/CFCT standards and protocols, and the IMF and World Bank have commended Mexico for these developments.

In the case of Mexico, a continuing focus on correspondent banking relationships appears to be misplaced. Over the past decade, the Mexican government and banking institutions have established modern systems to track transactions and comply with AML/CFCT standards and protocols, and the IMF and World Bank have commended Mexico for these developments. Other international bodies also have found that Mexico has fulfilled most international AML/CFT requirements, including amending its bank secrecy rules to support and comply with those efforts. International analysis also shows that Mexico presents a very small target for U.S. AML/CFT efforts as the country accounts for a very minimal share of global cross-border financial payments and transactions.

Despite these developments, U.S AML-CFT efforts continue to focus significantly on Mexico and its correspondent banking relationships with U.S. banking institutions. As a result, many banks in both countries have moved to reduce their regulatory costs and risks by reducing correspondent banking activities involving Mexico. This de-risking has especially affected smaller local and regional banks in Mexico. Moreover, econometric analysis shows that the reductions in cross-border correspondent banking relationships and values associated with AML/CFT efforts have resulted in slower growth in foreign direct investment and trade between the two countries than would have been expected, but for the AML/CFT focus on correspondent banking.

The analysis found that these AML/CFT efforts from 2012 to 2018 impaired FDI flows from Mexico to the United States by nearly $480 million per-year and impaired the U.S. stock of FDI by $3.3 billion and Mexico's stock of FDI by $1.4 billion in any given year. Further, these effects dampened U.S. growth by an estimated $5.5 billion per-year and slowed job growth by an average of nearly 41,000 jobs in any given year from 2012 to 2018. The decline in correspondent banking associated with the misplaced AML/CFT efforts also reduced Mexico's exports to the United States by nearly $75 billion from 2011 to 2021, dampening U.S. employment gains over that period by nearly 114,000 jobs.

These AML/CFT efforts focused on correspondent banking did not reduce the flow of remittances from people residing in the United States to family and friends. However, they have substantially reduced the numbers of banks in the remittance business, which in turn has increased the burdens and cost of sending and receiving remitted funds. Finally, the people adversely affected in this way are generally those least able to bear those associated burdens and costs, including lower-income individuals and those with marginal access to financial institutions.

Finally, the people adversely affected in this way are generally those least able to bear those associated burdens and costs, including lower-income individuals and those with marginal access to financial institutions.

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ENDNOTES

1 We gratefully acknowledge the support for this research provided by the Texas Association of Business. The analysis and conclusions are solely those of the authors.

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121 Ling, Salgado, Espinosa, and Serrano (2021).

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Rep. Sylvia Garcia Questions following House Financial Services Committee Hearing: "When Banks Leave: The Impacts of De-Risking on the Caribbean and Strategies for Ensuring Financial Access"

1. Ms. Delmar, can you please speak more on how de-risking practices impact remittance payments? How are senders and recipients negatively impacted, and what consequence does these difficulties have? Further, what can we learn about remittances in the Caribbean that can help us understand the issues that de-risking poses in Latin America?

Response by Wendy Delmar Caribbean Association of Banks

In the case of the Caribbean, which in most instances, countries GDP is primarily augmented by the tourist spend when they visit by air, or sea and also by remittances of family members overseas, who send monies to their families back home. The impact on the region has been quite significant in the following ways specifically:

- The dollar value of the funds received is "cut into" or diminished when charges and fees from the originator as well as the processing banks converge. The fees referred therein are incurred as a result of the need for heightened AML and KYC requirements by our local banks in processing transactions. The resultant impact is less disposable income is received by the recipient which has a negative net impact on the standard of living. It may be quite alarming if one is to recognize the significance placed by recipient families on receiving contributions from their family members overseas.

- It should also be noted, that remittances also assist in paying down student debt. Many Caribbean Nationals form the Caribbean diaspora, however, they maintain their debt including mortgages, student loans etc in their country of birth. In instances where the cost of sending money back home continues to increase, the funds received to settle those debts create a greater strain on the sender, forcing some to go into default, or properties to fall into areas thereby having an even greater impact on the servicing Banks in the region, who then see increasing non-performing loans becoming more of an issue.

- There is also a concern that people will find creative ways to circumvent systems to ensure that they can achieve a humane standard of living and support for their families. In this instance, when persons are forced to find alternate channels of receiving funds, this presents a further challenge to the Banking sector, in that there is no longer a means of tracking the movement of funds through legitimate sources, as is presented by the use of Banking channels. While this may not necessarily be the case, there is little information to determine the impact to this extent.

- As far as access to personal Banking services being provided and to ensure that we remain true to the desire to promote financial inclusion, Banks are now further hindered by their ability to be creative and innovative in meeting customer needs as there is always the fear of further jeopardizing delicate correspondent banking relationships.

- I also wish to point out that despite of the discussions endured over the years as it pertains to weak AML/KYC policies and practices, it was also highlighted during recent discussions with some of the Correspondent Banks that the Caribbean banks have been touted as having some of the more robust policies which sometimes are even more encompassing that the regulations require. As a result of the desire to ensure that we are meeting the needs of the correspondent banks, we have in turn alienated our people, who now see the process of banking to be vexing and frustrating, with many admitting that they have a less challenging time opening accounts in the US than they do at home. This sort of feedback in societies as small as ours is devastating on the Banking sector as we are relationship-based societies, where people enjoy building strong networks and also in the truest form, practice Knowing our Neighbors and Customers by extension.

  Again, as a result of rising mistrust with the Banking system, persons find ways of doing business outside of the system, thereby limiting our ability to track spending habits and patterns, which is of equal concern.

  Overall, as more and more persons opt out of the Banking system and move towards, “easier” options, the opportunities for financial planning and financial growth become stunted. The result is not only impactful on our people, but on our societies more wholistically.

While Latin America is in close proximity to the Caribbean or vise versa, the population sizes offer a very different experience than would obtain in the region. Also, given the limited access to capital that we face in the Caribbean, the impact of de-risking or the risk of being de-risked is perhaps less impactful than what obtains currently.

It has been noted recently, that the Correspondent Banks are now clearly articulating that one of the greatest challenges posed in doing business with Small Island Developing States (SIDS) is the inherent population size, which we have very little to no control over. This is in stark contrast to the population size and thereby the volume of activity that can be generated in the Latin American countries.

I hope that the above satisfies

Questions For the Record
Full Committee Hearing entitled, "When Banks Leave: The Impacts of De-Risking on the Caribbean and Strategies for Ensuring Financial Access"
Wednesday, September 14, 2022 at 10:00 a.m.

Witnesses

Second Panel:

- **Ms. Wendy Delmar**, CEO, Caribbean Association of Banks
- **Mr. Wazim Mohamed Mowla**, Assistant Director and Lead of the Caribbean Initiative, Adrienne Arsht Latin America Center, Atlantic Council
- **Mr. I. Wayne Shah**, Senior Vice President, Financial Institutions – Head of Caribbean Region, Wells Fargo Bank, N.A., and Executive Director, Financial & International Business Association (FIBA)
- **Mr. Amit Sharma**, CEO, Founder, and Director, FinClusive
- **Ms. Liat Shetret,** Director of Global Policy and Regulation, Elliptic

Causes of de-risking

1) **To all witnesses,** As the witness panel has presented, the lack of financial access for the Caribbean, especially through the loss of corresponding banking relationships, is devastating for the people, businesses, and economies of the region. Is there any one primary cause of this and therefore a so-called 'silver bullet' to immediately reverse this decade-long trend? Can we in Congress simply direct banks to open accounts or instruct the U.S. Department of the Treasury to take some action, thus fixing the problem overnight?

Response by Wendy Delmar

Based on our understanding of the events of the past years, due to regulatory changes, Correspondent Banks are taking a risk based approach to dealing with countries which are deemed high risk.

In order to address these perceptions which are utilized to brand and moreso to act on those perceptions, it is important to establish accountability and reasonability in accessing the lengths that industry players can exercise without impunity. It is critically important that institutions, agencies understand the impact of their judgements and at the very least it should become incumbent that decision such as these are not merely based on perceptions but should be empirically backed.

Caribbean Banks are forced to attempt to cure perceptions however, the institutions who come up with the information regarding the operations of the Banks do so without the need to provide evidence of their findings, which is unfortunate at best. Countries are being tarnished as a direct result of these black and grey lists which further negatively impacts the ability to attract foreign direct investment which is another staple of Caribbean existence.

In short, I cannot determine the ease with which the situation can be remedied, however, we must sit together to determine what are the avenues that exist to address this issue. We must take into consideration that a one size fits all approach to the issue cannot be utilized, as the Caribbean economies are delicate, but also equally useful and significantly contributory to the US economy.

2) **To all witnesses,** The Caribbean is a diverse region with 7000 islands across more than two dozen countries and non-sovereign states. Some of these nations have populations smaller than 100,000 people. We've heard that population size can play a role in the decision to de-risk.

   a) Can you please describe what role this population size plays in the financial access problem and which countries would you say are de-risked primarily for this reason?

Response by Wendy Delmar

- In recency, it has become very clear through open dialogue with Correspondent Banks that this is more than just AML/KYC, this is more than merely fines and penalties, but it also about profitability and volumes. Based on the population sizes of the Caribbean Islands, our volumes perhaps will never be substantial enough to warrant the re-entry of some correspondent banks. We have however noted that with the merges and acquisitions in some jurisdictions, the re-emergence of previously lost relationships have re-surfaced, which further strengthens the argument that this is a numbers, profitability issue.

   b) What are some methods that might be effective in combatting de-risking based on small population size?

Response by Wendy Delmar

- It would be well worth our while in determining if one or two major banks work with the regulators to establish policies and controls around small population serving to allow countries like ours to have a chance at survival.

- It is also an option to work with Caribbean regulators to establish a central processing unit through a designated central bank. This would allow for our local regulatory bodies to trend and assess risks from financial institutions which then allow for training of bankers to ensure that we "get it right". It also allows the central bank to drive down the costs of transactions processed by local banks as all volumes will go through the central bank creating a hub of Caribbean transactions. Most importantly, the processing of transactions through the regulators will allow for a greater sense of legitimacy for the US regulators and correspondent banks as these transactions would have gone through some level of scrutiny by the local regulators.

3) **To all witnesses,** Many incorrectly attribute the cause of de-risking to anti-money laundering (AML) laws and regulation, when more specifically, this one cause of many is a fear that the financial institutions, especially the correspondent banks, have of being penalized for their AML compliance failures. These laws and regulations are necessary, however, to protect the

financial system from abuse by bad actors like terrorists, kleptocrats, money launderers and other criminals.

a) Can you comment on how to strike a better balance between the necessity to defend our financial system from abuse and from the impact that money, for example for drug traffickers or terrorists, might have if left unchecked and the need to ensure that financial institutions are more engaged in the global financial system?

Response from Wendy Delmar:

- I actually believe that a stronger and more transparent working relationship with the Caribbean Banking system will promote a much stronger defensecan be made by ensuring that we are all aligned in monitoring and developing response mechanisms once breaches or avenues for weakness have been identified.

  As I have mentioned before, when societies utilize well established processes, for example the Banking system, we are able to determine what "normal flows" look like, however, as processes become more involved, persons will find alternate ways of getting business done and this leads to the potential for shadow banking to take route.

  The concept of de-risking essentially locks customers, banks, societies and countries out of the Global finanical system and this for all intents and purposes is counter-intuitive to the fight against Anti-Money Laundering and Terrorist Financing.

b) Are there changes to existing beneficial ownership, information sharing, or other regulations that would better enable banks to support correspondent banking in the Caribbean region?

4) **To all witnesses,** Among the causes of de-risking is the risk of banking individual and business clients who may be engaged in financial crime or sanctions evasion. Both correspondent and respondent banks must "know your customer" before opening accounts and as they monitor their transactions. In the de-risking context, this means that financial institutions, like a correspondent bank, may de-risk a customer whose risk, real or perceived, is deemed to be high. These same institutions may indiscriminately avoid engagement with groups of customers, like the nations, people, and businesses of the Caribbean region, due to the cost of managing that risk, real or perceived.

   a) How might financial technology or fintech help to better evaluate a customer's risk, thus lowering the costs of managing the risk and potentially bringing those individuals and legal entities back into the financial system?

Response by Wendy Delmar

- Fin Tech would undoubtedly play a major part in supporting a more efficient transaction process for the Caribbean Banking Sector. I am however, cautious that while this will alleviate some of the challenges faced, not all transactions will be facilitated through fintech and as such, the transaction which must continue to be processed otherwise, will see further reduction in volumes as well as dollar amounts. If this is fact the outcome, we would be in an even more dire situation with our Correspondent partners, as our profitability to them would be further diminished.

Effects of de-risking

5) **Ms. Delmar,** As the CEO of the Caribbean Association of Banks, your member banks need correspondent banks to do international transactions for their customers, a necessity for island nations that have to import goods and services, support the region's critical tourism industry, and receive remittances from family members living abroad.

   a) Is it correct that the number of correspondent banking relationships have dwindled over the last decade, with some countries experiencing periods where they've had not even a single correspondent banking option? If so, what is the effect of that on the nations where this has occurred?

   Response by Wendy Delmar

- We have seen quite a significant slide in the number of Correspondent Banks serving the region and while the loss impact is less in recency, there are still signs of withdrawal. There are also quite a number of respondent banks in the region which are serviced by one correspondent bank. This scenario is quite problematic as the regional banks continue to operate in an environment where they could lose all correspondent services with 30 days notice and very little option if this becomes the case.

- It can also be noted in a number of instances that the cost of doing business is becoming very expensive and inherently, these costs are then transferred to the customers.

- Further, where all correspondent banking services are lost, there is little that can be done to facilitate trade. Credit card payments cannot be processed, as was the experience in Belize. The direct impact is a significant drop in the quality of life within he affected societies, along with substantial impacts to the economies of these hard-hit countries.

   b) What steps have your members taken to try to revive the relationships with correspondent banks?

Response by Wendy Delmar:

- Banks within the region have worked extensively to strengthen internal processes in the hopes of attracting new relationships or re-attracting old ones. Significant amounts of money have been invested in upgrading technology, retraining and reskilling employees to meet the changing compliance requirements.
- New relationships have been forged to ensure that the Caribbean Banks are exposed to new technology, certified training personnel to name a couple.

6) **Ms. Delmar,** We have heard that the so-called "goalposts" for anti-money laundering improvements in the region keep moving, meaning that no matter what banks and nations of the Caribbean do to make AML improvements, they still cannot get the reliable, long-term financial access that we take for granted, here in the U.S. For your members, the respondent banks, what does that mean in terms of access to correspondent banking services? What does that mean in terms of the costs to Caribbean banks and their customers?

Response by Wendy Delmar:

- In terms of correspondent banking services, it means that despite enhancements to automated processes by local banks and within he sector, we have not been able to reattract lost correspondent banking relationships. In many instances, these relationships would have spanned decades, without issue or concern. It means that Banks within he region have spent significant sums of money correct what we believed to have been issues of laxed policies and procedures around AML and KYC in the hopes of getting back to the strong relationships once enjoyed to no avail.

- It means that local banks have traversed the region and even further afield in search of new correspondent banking service providers and in some instances lost hundreds of thousands of dollars, when those Banks have failed, taking with them the monies held in security for the provision of correspondent banking services.

- It means that locals banks have forfeited the ability to strategically utilize those funds to assist in developing the people and finding ways to create a culture of investment and inclusion for our small states.

- The monies which were spent in updating policies and procedures, in attempting to re-tool and re-skill our bankers, in terms of upgrading automated processes could have been invested in becoming more technologically ready for the changing demands of the people and communities that we serve and more importantly placed us on a path of readiness to respond to global changes.

Solutions to the de-risking problem

7) **To all witnesses,** Because correspondent banks often rely on income generated by fees, Caribbean countries with small populations face difficulty generating a large enough volume of activity to cover the banks' servicing costs. This includes anti-money laundering and sanctions compliance, particularly when each Caribbean country may have unique regulatory, legal, or enforcement frameworks that the correspondent banks are required to evaluate and navigate. For many years, it's been suggested that a novel hub or consortium bank, based at either a private bank in the U.S. or through a central bank like the Eastern Caribbean Central bank, might be useful to solving the low-volume, low-profitability component of the de-risking

problem. In essence, the middleman institution, with regional banks as its customers, would serve as the respondent bank for the correspondents, providing correspondent banks with one single customer to receive anti-money laundering screening. This could increase the volume of transactions from being spread across the Caribbean, creating a more profitable "fire hose" from multiple "garden hoses."

a) What do you think of this idea and what are the pros and cons of the concept?

Response by Wendy Delmar

- This would be a welcome opportunity to explore for the Caribbean Banking Sector and has also been recommended by The Caribbean Association of Banks for consideration.

b) What would Congress or the various stakeholders need to do to make this concept a reality?

Response from Wendy Delmar

- Congress would need to provide support for this initiative by reviewing the requirements and regulations which would govern such an entity alongside the various regulators and examiners to ensure that the model is a feasible one

8) **Mr. Mowla,** You and Mr. Jason Marcsak authored an excellent Atlantic Council report called, "Financial De-Risking in the Caribbean: The US Implications and What Needs to Be Done." It proposes a number of possible solutions to the de-risking problem for the Caribbean region. In that, you discuss categorizing correspondent banking as critical market infrastructure." Can you please expand on that to explain why this is important and how that would work?

9) **To all witnesses,** In the landmark Anti-Money Laundering Act of 2020, there is a mandate for the Government Accountability Office to produce a report on the many drivers of de-risking and to identify "options for financial institutions handling transactions or accounts for high-risk categories of clients and for minimizing the negative effects of anti-money laundering and countering the financing of terrorism requirements on such individuals and entities and on certain high-risk geographic jurisdictions…" That report was published in December 2021, and one of the ideas discussed is a "KYC [or Know Your Customer] utility," meaning a centralized repository for the customer information that financial institutions typically require for their anti-money laundering compliance.

a) What is your opinion of a shared database that collects the identifying information for customers for KYC purposes and would this help Caribbean banks to gain increased financial access?

Response from Wendy Delmar

The opportunity to facilitate a shared database is one which would alleviate a lot of the anxiety around data collection, mining and trending for the region and one which would be welcomed by the islands. Again however, we must be clear in articulating what is the extent of reach in accessing the information so as not to infringe on state privacy laws etc.

I am certain that the sector would be open to exploration on this topic.

10) **To all witnesses,** Most of the correspondent banks are the largest financial institutions like Wells Fargo, Citibank, and Bank of America. There are some small financial institutions offering this service, but it's unusual. The reason for this, one would imagine, is because it's expensive to maintain the overseas staff and branches and because the anti-money laundering and sanctions compliance is expensive. Is it a good idea to facilitate the entry of more small- and medium-sized financial institutions into the correspondent banking services? If so, how could the U.S. government encourage that while still maintaining high standards for combatting financial crime?

Response from Wendy Delmar:

Currently, the Caribbean Association of Banks is partnering with the Atlantic Council in hosting an inaugural US/Caribbean Banking Forum, alongside FIBA and other stakeholders. I firmly believe that endeavors such as these, with the backing of the US government will support in ensuring that the smaller US Banks see this as a viable business option.

There must however be a clearly articulated plan in ensuring that if in fact the perception of the region remains high risk that there is a monitoring of the associated costs of doing business with the region that does not then make it prohibitive for the Caribbean Banks to benefit from such relationships.

It is also important that a broad brush approach not be taken to the implementation of legislation and regulation as there are unique nuisances which define these SIDS. As such, it is incumbent on the regulators and examiners to recognize these differences and apply reasonability when accessing these islands, particularly if there is no empirical reason to cause just concern.

11) **To all witnesses,** One of the proposals before us today is an "examiners academy" which would level-set the knowledge and methodology used by examiners related to the Bank Secrecy Act. The reason for this is that how examiners in Omaha might evaluate a bank and its services is far different from how a bank in Miami might function. This is not to say that examiners do a poor job, but the question that's often raised is whether the business lines and customers and services are viewed as risky simply because they're different from the norm.

a) Can you please comment on what you hear from financial institutions about the exam process related to their banking business to or from the region?

Response from Wendy Delmar

There has been no negative feedback from member banks in regards the exam process.

b) Would examiners in the Caribbean region benefit from the opportunity to train with U.S. examiners, to help them to better understand the red flags of money laundering and terrorist finance and better apply standards that will attract correspondent banking services?

- While it may be beneficial for the Caribbean regulators to collaborate with US Regulators and examiners, this must be seen as an opportunity to strengthen ties and relationships as opposed to becoming yet another means of identifying weaknesses and penalizing the region or its members. We note that the INCSR was initially designed as a tool to determine which countries would benefit most from grants and financial support, however, today this report is being used as a means of determining the fate of countries which should be allowed to have access to Correspondent Banking services. We must be mindful that there must be reasonable transparency if the design and intent of programmes change to ensure that stakeholders are advised and notified and also that support tools are put in place to assist in transitioning. In short, I have no doubt that regulators will welcome every opportunity to support efforts at restoring Correspondent Banking services to the region, however, there should be clear indication of the anticipated outcomes and associated costs to drive interest.

12) **Ms. Shetret,** In your paper, entitled, "Understanding Bank De-Risking and Its Effects on Financial Inclusion: An Exploratory Study, you stated a recommendation to "Fast-track institutional development, such as that involving the financial intelligence unit or central bank, in order to facilitate trust-building in remittance-receiving countries' banking infrastructures and encourage foreign direct investment." Can you please expand on that? Do you mean a pilot project for remittances, to allow low-dollar amounts to move on a capped basis, with a lower anti-money laundering review threshold?

Malign Chinese influence

13) **To all witnesses,** Major Chinese banks have established correspondent banking and payment services arrangements with financial institutions in the Caribbean. On one hand, this is simply an example of international trade in services and China engages in this worldwide. On the other hand, these funds, along with low-cost support to infrastructure projects serve as parts of China's Belt and Road Initiative, which has been referred to as "a Trojan horse for China-led regional development and military expansion" because they buttress China's effort to spread power and influence across the globe.

a) What have you seen of Chinese banks in the region, for example in Guyana and the Bahamas? Is it true that they are stepping into the void left by departing correspondent banks? If so, what can the U.S. government do to counter this activity and the influence that it has in the region?

Response by Wendy Delmar

- China amongst other international territories are expressing interest in establishing or exploring relationships in the region. At this juncture, I am not sufficiently updated on the extent of the exploration or what advancements have been made to this extent with China, however, I do believe that if the Caribbean is really seen as the third border to the United States, it is empirical that the relationship and value of the US/Caribbean relationship be examined and frameworks be drawn up to ensure that a ringfence is established to protect this long standing and mutually beneficial relationship.

- I believe that rather than ex-communicating the Caribbean through de-risking, it would be most beneficial to all to support the development of the Caribbean to allow for enhanced monitoring, training, technological development of the region. In so doing, the Caribbean can perhaps been seen as a more valuable ally in the fight against crime, whilst also protecting the people and economies of the region.

- I believe that the US government can work with the regulators as well to develop a more balanced measure for vulnerable economies such as a the Caribbean to ensure that all of the efforts which are consistently demonstrated by the Caribbean banks, leaders and people work for the betterment of all.

Williams (GA) Questions for the Record
Financial Services Committee Hearing: "When Banks Leave: The Impacts of De-Risking on the Caribbean and Strategies for Ensuring Financial Access" Wednesday, September 14, 2022, at 10:00 a.m.

As someone who was once unbanked and left out of the financial system, one of my key focuses on this committee has been expanding financial inclusion, particularly for people who look like me.

This will not be the first or the last committee hearing where I will point out the racial disparities in financial inclusion. You've heard me say it before — in the United States, 13.8% of Black individuals were unbanked in 2019 while only 2.5% of white individuals were.

Today, we have also heard loud and clear that we have work to do even beyond our borders – especially for the Caribbean and its majority Black population – to ensure Black people can experience financial inclusion.

1. Ms. Delmar, can you describe the impact that de-risking has had on remittances and similar personal banking services available in the Caribbean, and what specific impact does this have on Black people and marginalized individuals in affected countries?

Response by Wendy Delmar - Caribbean Association of Banks:

The issues around de-risking are significant for all persons, however, as you have pointed out, there seems to be a significantly more severe impact on people of color and I say this in the context of the region, which is comprised of predominantly brown and black people. As I would have indicated before, the activity of de-risking in the Caribbean appears to have been a mass undertaking, driven by a perception of high risk associated with the jurisdiction.

In the case of the Caribbean, which in most instances, countries GDP is primarily augmented by the tourist spend when they visit by air, or sea and also by remittances of family members overseas, who send monies to their families back home. The impact on the region has been quite significant in the following ways specifically:

- The dollar value of the funds received is "cut into" or diminished when charges and fees from the originator as well as the processing banks converge. The fees referred therein are incurred as a result of the need for heightened AML and KYC requirements by our local banks in processing transactions. The resultant impact is less disposable income is received by the recipient which has a negative net impact on the standard of living. It may be quite alarming if one is to recognize the significance placed by recipient families on receiving contributions from their family members overseas.

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- There is also a concern that people will find creative ways to circumvent systems to ensure that they can achieve a humane standard of living and support for their families. In this instance, when persons are forced to find alternate channels of receiving funds, this presents a further challenge to the Banking sector, in that there is no longer a means of tracking the movement of funds through legitimate sources, as is presented by the use of Banking channels. While this may not necessarily be the case, there is little information to determine the impact to this extent.

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FINANCIAL & INTERNATIONAL BUSINESS ASSOCIATION

HEARING BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
"When Banks Leave: The Impacts of De-Risking on the Caribbean and Strategies for Ensuring Financial Access"
September 14, 2022

The Financial and International Business Association (FIBA) Inc. appreciates the opportunity that we were given to have Executive Committee member Wayne Shah testify before the House Financial Services Committee on the important issue of de-risking in the Caribbean. As the leading voice for international banking in the U.S., Latin America, and the Caribbean, FIBA was the first to raise concerns about the potential loss of support for correspondent banking in the Caribbean region and created the Caribbean Roundtable in 2007. Over the next several years, FIBA focused on this issue inviting stakeholders from Caribbean governmental agencies, Caribbean financial institutions, the U.S. Treasury Department, U.S. financial institutions, and U.S. regulatory agencies, to debate the causes and potential solutions[1]

Over the years of derisking, FIBA could not find any empirical evidence to believe that Caribbean banks had lesser abilities regarding BSA/AML. In fact, our view was that the Caribbean banks that remain in the market have invested heavily in BSA/AML compliance enhancements and risk management measures and are currently highly compliant with international guidelines and industry best practices. Yet they are always weary that reality does not always reflect perception.

From the FIBA perspective, U.S. national security depends on prosperity and stability in the hemisphere. By fostering inability to establish financial links to our neighbors, we weaken the region, our alliances, and ultimately ourselves. Healthy business relations facilitated by correspondent banking is an essential cog in that wheel.

The observations made by FIBA were clear signs that there has been a change in perception of the risk the Caribbean region poses driven largely by regulatory changes and the financial crisis of the time. FIBA noticed the following trends:

- Correspondent banks were primarily concerned about getting their BSA/AML house in order during the crisis, rather than sharing their concerns and improvements with their customers.

[1] Please see addendum presentation made to the Association of Supervisors of Banks of the Americas "De-Risking: How is it impacting correspondent banking in the region and what are the solutions?"

FINANCIAL & INTERNATIONAL BUSINESS ASSOCIATION

- New regulations and the fear of large fines created a big push by global correspondent banks to shore up their risk management infrastructure. The result is a new and excessively high standard for risk appetite. Concern regarding BSA/AML Compliance was driven by massive regulatory fines for noncompliance and correspondents were moving to a zero-tolerance model.
- High risk products offered by correspondent banks were under scrutiny and sometimes not offered or exited. The move by correspondent banks to eliminate the use of check clearing services is one such example.
- Exaggerated concerns over narco trafficking, human trafficking, tax havens, and rampant corruption made a case for extended scrutiny and exits. The International Narcotics Control Strategy Report (INSCR) was being used as a reference for wrongdoing by Caribbean nations, even though most nations were not appropriately engaged to respond to the concerns expressed therein.
- Correspondents were using published grey and blacklists to justify reduction of services or to exit.
- Correspondents wanted respondents to mirror their over-scaled infrastructure for risk management and not being able to implement expensive technologies or respond immediately to policy adjustments was seen as a cause for concern.
- Correspondents passed on the cost of their U.S. AML infrastructure spend to the smaller jurisdictions, claiming that the cost of compliance and monitoring was too high even though the per transaction costs were absorbed and spread across global flows.
- De-risking was initially limited to indigenous banks who were small in scale and had a reduced opportunity to deliver lucrative short-term revenues. These banks had no voice or alternative except to accept a 30-day notice of closure.

FIBA's Caribbean Roundtable was successful in identifying the cause and effect of early de-risking which served to alert members to the phenomenon at large. Diligent discussions with all stakeholders over the years raised awareness and caused Caribbean banks to up their game regarding BSA/AML. FIBA was instrumental in providing much needed training courses, webinars, and leadership. As the organization identifying and responding to the phenomenon of de-risking, FIBA actively participated and was a key contributor to the efforts of a variety of organizations that also became active in the de-risking space. FIBA's contribution to the work surrounding de-risking is noted in the support of findings by the Caribbean Association of Banks (CAB) and International Monetary Fund (IMF - 3 sessions), and most recently BAFT and the Atlantic Council.

As de-risking continued and U.S. correspondent banks began to shed relationships, FIBA noticed that the de-risking was disproportionately geared to the smaller banks in the smaller islands. The impacts were clear, and the pains severe, as smaller banks were no longer able to support their customers international business via:

- Access to international markets.
- Foreign payments and trade services.
- Cross border credit cards.

The other financial services necessary to support tourism, net foreign investments, international payments, and trade finance continued to be available through the larger unaffected financial institutions. Alternatively, FIBA did not observe stakeholders from the region complain of wholesale desertion by U.S. correspondent banks during the peak of de-risking.

Canadian banks with branches and subsidiaries in the Caribbean were unscathed by de-risking, and large indigenous systemically important banks were able to retain and maintain multiple correspondent relationships. International flows of commercial activity from the de-risked banks made its way naturally to the larger respondent banks that provided support to local economies.

In FIBA's opinion the advent of de-risking as documented has long been over. The remaining major challenges about financial inclusion for the Caribbean are:

- Making sure history does not repeat itself and de-risking does not affect the larger banks.
- Creating a mechanism for correspondent banks to return to servicing the region in a wholesome and prudent way.
- Sustaining a view that the Caribbean is a region of safety and soundness for financial services and inclusion.
- Working with correspondent banks to perform independent country and counterparty risk analysis instead of obscure publications that may or may not be substantiated by fact or corroboration.

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- Open-ended regulatory mandates for AML/CIP/KYC leave too much discretion with regulatory rulemaking and create unascertainable cost analyses for small-to-mid sized community banks wishing to develop these correspondent ties.
- Avoiding unintended consequences of new regulation and legislation. Examples are section 6308 of the Anti-Money Laundering Act of 2020, which provides broadened subpoena authority to the Department of Justice, and the proposed lowering of the threshold of the Travel Rule for cross-border transfers. Such mandates can exert undue pressure on correspondents and respondents.

We also are prepared to support Chairwoman Waters' proposed AML Examiners Training Academy and applaud the inclusion of "employees of foreign governments" including "agencies of foreign governments which supervise financial institutions" therein. Due to our diverse membership which includes banks from the U.S., Europe, Latin America, and the Caribbean that are involved in international banking, FIBA has extensive experience training regulators, government officials, and bankers internationally on the application of U.S. and international AML/CFT standards. This includes, the Caribbean and Latin American regions, through our AML compliance certifications launched in 2007 with Florida International University, bank board trainings, and other continuing education events. This culminates in an exchange of ideas at our Annual AML Compliance conference now in its 23rd year.

There were questions posed to Mr. Shah and other panelists during the hearing that we wish to address here.

- If U.S. financial institutions are exiting from correspondent banking who is stepping into the Caribbean market? Any other commercial banks that have stepped in from Europe or elsewhere? We have seen payment processors and banking type organizations such as Western Union, MoneyGram, and Crown Agents stepping in.
- Can cryptocurrency and/or CBDC solve the problem? This was discussed during the hearing, however, we felt that it was important to revisit the issue. De-risking was not about having access to currency but access to the U.S. banking system. It was agreed that the reasons for de-risking were concerns over the adequacy of compliance programs, country risk, and scale amongst others which cannot be resolved using cryptocurrency or a CBDC. As concluded during the hearing, the latter are solutions in search of a problem and de-risking is not the appropriate problem.

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One final idea that we would like to submit for consideration that we raised several years ago: consolidate the flows from the de-risked jurisdictions through a bank chartered in South Florida that would be supervised and regulated by a U.S. Federal Functional Regulator. As correspondent banking is a highly specialized line of business, we would recommend that the institution be staffed with experienced local correspondent banking, operational, and compliance personnel to ensure a strong AML/CFT program that would make the bank an attractive respondent. Capital contributions would come from the affected jurisdictions.

FIBA and its members are committed to working with the Caribbean region in support of the region's growth and will continue to be a thought leader and steward for financial inclusion. We stand at the ready to assist in any way necessary to move this important initiative forward.

Submitted on behalf of the Financial & International Business Association (FIBA), Inc.

David Schwartz
President & CEO

POSITION PAPER ON DE-RISKING CORRESPONDENT BANKING AND TRADE FINANCE, THE COST OF DOING BUSINESS, AND BASEL III

On September 28, 2016, Thomas Curry, Comptroller of the Currency made certain public remarks concerning the issue of "de-risking" of banks' exposure in their international business portfolios. Mr. Curry was referring specifically to trade finance and correspondent banking, areas in which FIBA has focused for the past 4 years. Mr. Curry has chosen to call the process "risk reevaluation" as he considers the term de-risking to be pejorative. For our purposes, the terms "de-risking", "de-banking" and "risk reevaluation" all have the same significance: banks are simply eliminating or reducing a particular line of business for a host of reasons, mostly related to costs. The question is "why have costs risen to the point that it is no longer economical to have correspondent banking and trade finance relationships and is de-risking reversible or even preventable?"

Mr. Curry argues that the federal bank regulatory agencies have tried to "dispel the misperceptions about what is expected of U.S. banks with foreign correspondent businesses and that under existing U.S. regulations there is no general requirement for U.S. depository institutions to conduct due diligence on the customer of their foreign correspondent partners. In other words, there is no general requirement to know your customer's customers."

Mr. Curry also indicates that the OCC will soon issue guidelines for best practices which the banks can use to make decisions about retaining or terminating a foreign correspondent account. In effect, the OCC wants banks to justify their decision to terminate a particular relationship.

Mr. Curry's complete comment reads:

"These practices include establishing effective governance for overseeing how banks reevaluate risk and monitor recommendations for retaining or terminating foreign correspondent accounts. They also include regularly communicating to senior management about decisions to retain or terminate foreign correspondent accounts, giving consideration to any adverse impact that closures may have on access to financial services for an entire group of customers or an entire region. Banks with best practices establish lines of communication with foreign correspondent customers in the context of determining whether to withdraw from a relationship. Best practices also consider specific information these customers may provide that may mitigate risks they present. And, when decisions are made to terminate accounts, banks with best practices provide sufficient time for customers to establish alternative banking relationships, unless any delay would create additional risk. Finally, best practices among banks with foreign correspondent business include having clear audit trails documenting the reasons and methods used for considering account closure."

U.S. TREASURY POSITION ON CORRESPONDENT BANKING

U.S. depository institutions that maintain correspondent accounts for foreign financial institutions (FFIs) are required to establish appropriate, specific, and risk-based due diligence policies, procedures, and processes that are reasonably designed to assess and manage the risks inherent with these relationships. To comply with their legal obligations, U.S. depository institutions must monitor transactions related to these accounts to detect and report suspicious activities. These policies, procedures, and processes will depend on the level of risk posed by the correspondent FFI. Such risks can vary depending on the FFI's strategic profile, including its size and geographic locations, the products and services it offers, and the markets and customer bases it serves.

In order for U.S. depository institutions to develop a clear understanding of FFI risk profiles and determine how best to manage the risks associated with these relationships, U.S. banks are expected to obtain and review sufficient information about their FFI relationships, including the types of customers the FFI serves and the markets in which the FFI is active. This approach allows the U.S. depository institution to conduct an adequate assessment of the risks present in: (i) the FFI's business and markets, (ii) the type, purpose and anticipated activity, (iii) the nature and duration of the relationship with the FFI, and (iv) the supervisory regime of the jurisdiction in which the FFI is licensed. Once risks are identified and assessed, the U.S. depository institution must design and implement controls to manage such risks effectively.

However, as indicated above, there is no general requirement under existing U.S. law and regulation for U.S. depository institutions to conduct due diligence on an FFI's customers. Instead, in determining the appropriate level of due diligence necessary for an FFI relationship, U.S. depository institutions should consider the extent to which information related to the FFI's markets and types of customers is necessary to assess the risks posed by the relationship, satisfy the institution's obligations to detect and report suspicious activity, and comply with U.S. economic sanctions. This may require U.S. depository institutions to request additional information concerning the activity underlying the FFI's transactions in accordance with the suspicious activity reporting rules and sanctions compliance obligations.

SOME BASIC FACTS ABOUT WORLD TRADE AND FINANCE

According to the World Trade Organization ("WTO") in its July 2016 report, the value of merchandise trade and trade in commercial services declined in 2015 and has been almost flat for the last 4 years. This is partly due to a drop in commodity prices generally and a 45% drop in energy prices. Another significant reason for the decline in trade has to do with lack of availability of trade finance. According to the WTO "80-90% of world trade requires some form of finance or credit insurance". Dr. Roberto Azevedo, Director General, said in May 2016:

"There are also indications that markets are even more selective after the 2008 crisis. Under increased regulatory scrutiny many institutions have lowered their risk-appetites and are focusing more on their established customers. Some are deliberately decreasing their number of clients in a so-called "flight to quality".

So, for many, it has become more difficult to obtain trade finance. And some big gaps in provision have emerged.

For example, in Africa, almost one third of the requests for trade finance are rejected by banks. In Asia, the estimated number of requests for trade finance rejected is approaching one trillion dollars. All in all, the global trade finance gap is estimated to be around 1.4 trillion dollars annually. And the poorer the country, the more difficult it is.

In developing countries, the alternatives to bank financing such as inter-company lending and factoring may simply not exist. Trade credit insurance may not be available, and the legal framework for factoring may not be in place.

And amid these factors, small and medium-sized enterprises are the most affected. Even in developed countries, trading SMEs face much greater challenges than larger firms."

Based on empirical evidence and surveys conducted in New York and Miami, a similar situation has occurred with availability of trade finance in Latin America and the Caribbean. Whereas some years ago, most financial institutions (both large multinationals and community banks) had dozens of correspondent banks in the area with multiple trade finance lines of credit, the number of banks providing this service today has shrank to a small fraction of what it used to be.

FIBA's POSITION

On October 19, 2012, FIBA delivered a letter to Mr. Curry, with copies to the FDIC and the Federal Reserve Board indicating that the then-proposed risk weights under Basel III would have a serious negative impact on trade finance with potentially severe adverse effect on emerging markets.

FIBA followed up with letters on November 19, 2013 to Mr. Curry and other federal bank regulatory agencies. On May 9, 2014, we sent a letter to the Regional Director of the FDIC in which we amply discussed the impact of Basel III on trade finance availability. Subsequently, on December 1, 2014, the Florida Delegation in Congress wrote to Janet Yellen, Chair of the Federal Reserve Board, expressing a similar concern.

Our letter of November 19, 2013 partially indicated that "Any unwarranted interruption of the financing of international trade is bound to have a negative impact on all our trading partners and various trade agreements already in effect. The new rules may increase the commercial account deficit and will have a serious repercussion on employment in the State of Florida where it is estimated 1,300,000 persons depend on international business. Of these, it is estimated 1,100,000 jobs are linked to international trade. Over 95% of all exporters in Florida are considered small and medium enterprises with fewer than 500 employees. One out of every 6 jobs in our State is dependent on international business."

We also pointed out that trade finance **WAS NOT** an issue during the financial crisis of 2008 and that there is no empirical evidence to suggest that trade finance is riskier than other forms of finance. In fact, the opposite is true: the default rate on trade finance is generally 0.013% with a loss rate of about 0.0007%. In loans to foreign banks, the default rate is only 0.09%

The federal bank regulatory agencies have consistently ignored pleas from industry and trade associations worldwide to understand the negative impact of higher capital ratios on trade finance, which has increased the costs to the banks at a time when profit margins have been under pressure due to persistently low interest rates.

At the same time, the regulatory cost of compliance for banks has been increasing year after year. According to published reports of the Bank of England, “legal costs of $275 billion since 2008 translates into more than $5 trillion of reduced lending capacity” (Minouche Shaffik, Deputy Governor of the Bank of England).

Simply put, Anti-Money Laundering rules, coupled with higher capital requirements, lower net interest margins, reputational fear and general compliance costs, have made it very difficult for banks to do business outside the United States, particularly in emerging markets which are not well-known to U.S. bank examiners. As Christine Lagarde, IMF Managing Director correctly said recently: “large banks are withdrawing from smaller countries” to which we would also add: all banks, not just large banks, are rethinking their positions on trade finance and correspondent banking.

The federal bank regulatory agencies consistently argue that their rules do not explicitly instruct any bank to terminate a particular line of business or exit from exposure to a particular country. However, they fail to understand that the ramifications of the application of their rules, as applied by examiners in the field, have the same practical effect as telling an institution to conduct a “risk reevaluation” of its line of business. This is particularly true in any product defined as “High-Risk” by the BSA rules, which includes correspondent banking, dealing with MSBs of any kind and others.

FIBA also believes it would be wrong to force an institution to justify its decision to terminate a relationship. In fact, it may make it even more difficult for any institution to commence a new relationship if it knows that it must have an “audit trail” to justify the maintenance of the relationship in case it must close it later. This will only increase the cost of the relationship upfront with negative consequences.

CONCLUDING REMARKS

The decision to maintain or to close an account relationship should reside solely and exclusively in the domain of the banks and should not be subject to regulatory interpretation by bank regulators, let alone field examiners. Any attempt to force banks into a line of business which they have concluded is unwarranted, will result in additional costs to everyone concerned with more negative consequences. These decisions are not made “overnight” and are typically the result of an internal cost-benefit analysis which should not be questioned by examiners. What is important is to reduce the costs and the burden of carrying those relationships. Instead of new guidelines which add another layer of interpretations, and which will always be subjective in nature, we would propose that examiners be better prepared to understand the risks of trade finance and the nature of correspondent banking.

Banks are in the business of risk. The objective is to control and minimize every risk, and to make sure that the product or business line provides a reasonable return to its stakeholders. Banks cannot avoid risk except by eliminating a business or product, which they do only when the risks associated with that product or line exceed the expected returns. One of the biggest risks is the reputational risk associated with an innocent violation or perceived violation of a banking rule or regulation, particularly those dealing with BSA/AML.

It is not up to U.S. banks to establish business policy based on diplomatic considerations as implied in the remarks of the OCC. Correspondent banking and trade finance are as old as banking and it is practiced by most large institutions and many small community banks in trading cities like Miami, New Orleans, Houston and others. Lending to FFIs is an inherent high risk product, as defined by the government's BSA Manual. It is high-risk because of the BSA/AML component associated with the transactions that could flow through the FFI without the U.S. bank's knowledge or control. However, it is not a high-risk credit product based on historical loss experience for the simple reason that foreign central banks will inarguably differentiate and protect trade finance from other forms of credit. Without lines of credit from correspondent banks in developing economies, those emerging markets will suffer economic consequences, as already discussed above and explained by the OCC and others.

The Federal Reserve Board and other federal bank regulators are also complicit in drafting Basel III rules that penalize trade finance by assigning a higher than usual risk-weight capital ratio. If we are serious about lowering the cost of trade finance and serious about increasing available facilities and restoring correspondent accounts, we must revise our policy and propose more flexible standards. FIBA has done extensive research on the subject and has proposed guidelines that will allow for this to happen without compromising the safety and soundness of our banking system. We urge our legislators and all bank regulatory agencies to review this matter as soon as possible.

November 14, 2022

Via Electronic Mail

The Honorable Maxine Waters
Chairwoman
U.S. House Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairwoman Waters:

Thank you for the questions for the record from the September 14, 2022 hearing entitled "When Banks Leave: The Impacts of De-Risking on the Caribbean and Strategies for Ensuring Financial Access." Per your request, please find enclosed my written responses to the questions provided to all witnesses.

Sincerely,

Wayne Shah

Senior Vice President
Financial Institutions – Head of Caribbean Region,
Wells Fargo Bank, N.A.

Executive Director
Financial & International Business Association (FIBA)

cc: The Honorable Patrick McHenry, Ranking Member

<u>Causes of de-risking</u>

1) To all witnesses, As the witness panel has presented, the lack of financial access for the Caribbean, especially through the loss of corresponding banking relationships, is devastating for the people, businesses, and economies of the region. Is there any one primary cause of this and therefore a so-called 'silver bullet' to immediately reverse this decade-long trend? Can we in Congress simply direct banks to open accounts or instruct the U.S. Department of the Treasury to take some action, thus fixing the problem overnight?

Reversing a decade-long trend overnight will be difficult. Access to the USD clearing system, and correspondent products and services that enable trade, development, and regional support all promote the priority of the adoption of the USD as a world trade and reserve currency.

There really is not a "silver bullet" approach. Foreign correspondent banking requires building relationships and understanding the market, partners, customers, products and services, as well as the overall risks associated with foreign correspondent banking.

2) To all witnesses, The Caribbean is a diverse region with 7000 islands across more than two dozen countries and non-sovereign states. Some of these nations have populations smaller than 100,000 people. We've heard that population size can play a role in the decision to de-risk.

a) Can you please describe what role this population size plays in the financial access problem and which countries would you say are de-risked primarily for this reason?

Population size may not necessarily play a role in decision making; however, there is a likely correlation between population size and business opportunity. When evaluating a country or counterparty for correspondent services, financial institutions should consider the risks and the financial benefits of a particular relationship to determine if the business supports the compliance cost, and the operational, servicing, regulatory, and reputational risks associated with the relationship.

b) What are some methods that might be effective in combatting de-risking based on small population size?

One opportunity to address volume concerns would be to pool small operational flows through down streaming via larger, local banks already familiar with the market.

Regulatory safe harbors, generally accepted mitigation practices, and more government recognition and incentivization of the importance of providing correspondent banking services to underserved populations could also ease some of the significant resources and commitments that foreign correspondent relationships require.

3) To all witnesses, Many incorrectly attribute the cause of de-risking to anti-money laundering (AML) laws and regulation, when more specifically, this one cause of many is a fear that the financial institutions, especially the correspondent banks, have of being penalized for their AML compliance failures. These laws and regulations are necessary,

however, to protect the financial system from abuse by bad actors like terrorists, kleptocrats, money launderers and other criminals.

a) **Can you comment on how to strike a better balance between the necessity to defend our financial system from abuse and from the impact that money, for example for drug traffickers or terrorists, might have if left unchecked and the need to ensure that financial institutions are more engaged in the global financial system?**

AML laws and regulations, which are intended to be risk-based, are essential to the financial system. Foreign correspondent banking involves various levels of risk undertaking and mitigation, which can vary depending on the counterparty, local AML regulations, and products and services being offered.

Due to the complexity involved in foreign correspondent banking, stakeholders must understand the market and the business to be able to identify and manage risk. All risks are not the same. Different organizations, depending on their scale, infrastructure, staffing, and deployment of appropriate technologies, can mitigate or eliminate certain risks more easily than others.

Banks can – and do – effectively manage third-party risk with a variety of approaches and practices. Regulatory safe harbors, generally accepted mitigation practices (such as uniform customer due diligence expectations), and government recognition and incentivization of the societal value of providing correspondent banking services to underserved populations would help respondent banks as they evaluate whether to provide foreign correspondent banking services. Additionally, if respondent banks have developed proven, effective risk management programs, this helps tip the balance in favor of more engagement in these markets.

b) **Are there changes to existing beneficial ownership, information sharing, or other regulations that would better enable banks to support correspondent banking in the Caribbean region?**

Sharing of beneficial ownership information should be a two-way street, with cooperation from both jurisdictions.

4) To all witnesses, Among the causes of de-risking is the risk of banking individual and business clients who may be engaged in financial crime or sanctions evasion. Both correspondent and respondent banks must "know your customer" before opening accounts and as they monitor their transactions. In the de-risking context, this means that financial institutions, like a correspondent bank, may de-risk a customer whose risk, real or perceived, is deemed to be high. These same institutions may indiscriminately avoid engagement with groups of customers, like the nations, people, and businesses of the Caribbean region, due to the cost of managing that risk, real or perceived.

a) **How might financial technology or fintech help to better evaluate a customer's risk, thus lowering the costs of managing the risk and potentially bringing those individuals and legal entities back into the financial system?**

Correspondent banks with effective risk mitigation programs have policies, procedures, and monitoring technologies to guard against suspicious activities or customers. Technology can streamline and standardize certain risk-based processes, such as collecting customer due diligence information. For example, a small domestic local bank may view certain activity or relationships as presenting higher-risks than those activities or relationships would present to a large multinational bank that effectively uses up-do-date technology and systems and maintains an extensive mitigation infrastructure.

Perceived risk levels can cause banks to de-risk or choose not to enter a specific market. Fintechs acting alone or as third-party service providers may help lower barriers by reducing perceived risk if they are able to work in these markets, understand the risks, and obtain appropriate customer due diligence information that U.S. banks would require. If Fintechs that provide the same services as banks are not held to the same standards, illicit actors may attempt to exploit those differences.

Solutions to the de-risking problem

7) To all witnesses, Because correspondent banks often rely on income generated by fees, Caribbean countries with small populations face difficulty generating a large enough volume of activity to cover the banks' servicing costs. This includes anti-money laundering and sanctions compliance, particularly when each Caribbean country may have unique regulatory, legal, or enforcement frameworks that the correspondent banks are required to evaluate and navigate. For many years, it's been suggested that a novel hub or consortium bank, based at either a private bank in the U.S. or through a central bank like the Eastern Caribbean Central bank, might be useful to solving the low-volume, low-profitability component of the de-risking problem. In essence, the middleman institution, with regional banks as its customers, would serve as the respondent bank for the correspondents, providing correspondent banks with one single customer to receive anti-money laundering screening. This could increase the volume of transactions from being spread across the Caribbean, creating a more profitable "fire hose" from multiple "garden hoses."

a) What do you think of this idea and what are the pros and cons of the concept?

Aggregating volumes from different local financial institutions may create more financial incentives. However, aggregating flows from various foreign financial institutions, with different risk management capabilities, AML requirements, and controls processes, could obscure the details of the activity and the customers underlying those activity flows.

Such an arrangement raises a number of questions: How would a U.S. correspondent validate and have line of sight into these transactions to determine legitimacy? Which organization assumes the regulatory risks? Who is responsible when things go wrong or when there are inquiries regarding the originator or beneficiary?

The location of the consortium bank will offer specific challenges. If the bank is in the United States, it will be subject to the same requirements and oversight as a U.S. correspondent bank and will be required to have similar infrastructures, policies, procedures, technologies, and management capabilities.

If the bank is in the Caribbean, then it will require a correspondent bank for USD clearing. Pooling of flows, unchecked ownership details, and collecting customer due diligence information will pose a challenge, not to mention the handling of requests for information, filing of SARs, and responding to audits.

b) What would Congress or the various stakeholders need to do to make this concept a reality?

Address the above concerns as well as support the issuance of a license or mandate for a concentration bank, or provide some relief to a U.S. correspondent bank supporting them. Regulatory safe harbors, generally accepted standardized risk mitigation practices, and an explicit recognition and incentivization by Congress of the value of providing banking services to underserved populations would help respondent banks considerably.

Another option for extending correspondent services is to encourage down streaming through already existing banks with existing correspondent relationships.

9) To all witnesses, In the landmark Anti-Money Laundering Act of 2020, there is a mandate for the Government Accountability Office to produce a report on the many drivers of de-risking and to identify "options for financial institutions handling transactions or accounts for high-risk categories of clients and for minimizing the negative effects of anti-money laundering and countering the financing of terrorism requirements on such individuals and entities and on certain high-risk geographic jurisdictions…" That report was published in December 2021, and one of the ideas discussed is a "KYC [or Know Your Customer] utility," meaning a centralized repository for the customer information that financial institutions typically require for their anti-money laundering compliance.

a) What is your opinion of a shared database that collects the identifying information for customers for KYC purposes and would this help Caribbean banks to gain increased financial access?

Standardized acceptable risk mitigation practices could be a potential partial solution. A centralized KYC database could help with the burden associated with KYC requirements. Because KYC and due diligence is risk-based, financial institutions could require additional information; however, minimum available KYC information could ease overall KYC burdens. In order for centralized databases to work, the regulators must clarify that banks that use the database will be in compliance with the regulators' CDD requirements.

Keeping database information relevant and accurate would be a challenge and raises certain questions. For instance, who will be responsible when there is incomplete data or inaccurate information? How will discrepancies be resolved? How will the information in the database be verified? Can banks rely on the information in the database?

10) To all witnesses, Most of the correspondent banks are the largest financial institutions like Wells Fargo, Citibank, and Bank of America. There are some small financial institutions offering this service, but it's unusual. The reason for this, one would imagine, is because it's expensive to maintain the overseas staff and branches and because the anti-money

laundering and sanctions compliance is expensive. Is it a good idea to facilitate the entry of more small- and medium-sized financial institutions into the correspondent banking services? If so, how could the U.S. government encourage that while still maintaining high standards for combatting financial crime?

Small and medium-sized financial institutions may be willing to provide financial services to markets and counterparties that large banks have exited or to which large banks, based on risk and other factors specific to that bank, have decided not to provide correspondent services. Small and medium-sized financial institutions might be in a better position to tailor their risk mitigation programs to particular customers or geographies and perhaps manage the risks associated with foreign correspondent banking in a more focused, streamlined, and cost-effective manner.

11) To all witnesses, One of the proposals before us today is an "examiners academy" which would level-set the knowledge and methodology used by examiners related to the Bank Secrecy Act. The reason for this is that how examiners in Omaha might evaluate a bank and its services is far different from how a bank in Miami might function. This is not to say that examiners do a poor job, but the question that's often raised is whether the business lines and customers and services are viewed as risky simply because they're different from the norm.

a) **Can you please comment on what you hear from financial institutions about the exam process related to their banking business to or from the region?**

Whether accomplished through training or other means, banks generally are looking for consistency in the examination process, including with respect to the Caribbean region. This includes a consistent approach in examining the risks and risk mitigation efforts, and if additional training for the Caribbean region would help level-set, banks would welcome that. In this region and all regions, examiners should look at the specific risk of providing foreign correspondent banking services to particular customers and geographies and the effectiveness of a bank's risk mitigation program.

b) **Would examiners in the Caribbean region benefit from the opportunity to train with U.S. examiners, to help them to better understand the red flags of money laundering and terrorist finance and better apply standards that will attract correspondent banking services?**

For AML/CFT issues, there is cooperation and information sharing between the U.S. and Caribbean countries through organizations like the FATF and the Egmont Group, but any opportunity to increase shared understandings in this area could potentially help both U.S. and Caribbean examiners.

Malign Chinese influence

13) To all witnesses, Major Chinese banks have established correspondent banking and payment services arrangements with financial institutions in the Caribbean. On one hand, this is simply an example of international trade in services and China engages in this worldwide. On the other hand, these funds, along with low-cost support to infrastructure projects serve as parts of China's Belt and Road Initiative, which has been referred to as "a

Trojan horse for China-led regional development and military expansion" because they buttress China's effort to spread power and influence across the globe.

a) **What have you seen of Chinese banks in the region, for example in Guyana and the Bahamas? Is it true that they are stepping into the void left by departing correspondent banks? If so, what can the U.S. government do to counter this activity and the influence that it has in the region?**

The focus should be on the promotion of the USD as a trade currency. When access to USD services is curtailed, the market may naturally look to a substitute currency like GBP, EURO, YEN or Renminbi, if there is a perceived benefit to making the switch.