

## Recent Trends in Correspondent Banking Relationships—Further Considerations



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## RECENT TRENDS IN CORRESPONDENT BANKING RELATIONSHIPS—FURTHER CONSIDERATIONS

### EXECUTIVE SUMMARY

**Correspondent banking relationships (CBRs), which facilitate global trade and economic activity, have been under pressure in several countries.** So far, cross-border payments have remained stable and economic activity has been largely unaffected, despite a recent slight decrease in the number of CBRs. However, in a limited number of countries, financial fragilities have been accentuated as their cross-border flows are concentrated through fewer CBRs or maintained through alternative arrangements. These fragilities could undermine affected countries' long-run growth and financial inclusion prospects by increasing costs of financial services and negatively affecting bank ratings.

**Factors leading to global banks' withdrawal of CBRs are multiple, interrelated, and vary case-by-case.** They generally reflect correspondent banks' assessment of the profitability and risk of the relationships. In particular, decisions to terminate CBRs often relate to the correspondent bank's lack of confidence in the respondent bank's capacity to effectively manage risk. Recent changes in the regulatory and enforcement landscape have contributed to this phenomenon, notably with respect to more rigorous prudential requirements, economic and trade sanctions, anti-money laundering and combating the financing of terrorism (AML/CFT) and tax transparency standards.

**Addressing the withdrawal of CBRs will take time and would require strengthened, coordinated and collective action on the part of public and private stakeholders.** The first port of call for all countries concerned with the withdrawal of CBRs includes measures to enhance respondent banks' capacity to manage risks, improve communication between correspondent and respondent banks, strengthen and effectively implement regulatory and supervisory frameworks in line with international standards, particularly for AML/CFT and remove impediments to information sharing. Other initiatives to address the underlying drivers of CBR withdrawal, particularly those related to correspondent banks' profitability and risk assessment concerns, should be considered, though they tend to have more limited impact. In the event of a complete loss of CBRs by all commercial banks in a country, the public sector should also consider the feasibility of temporary mechanisms, including public-backed vehicles, to provide payment clearing services.

**The Fund has an important role to play in monitoring risks and advising its membership on policies to help tackle the adverse impacts from the withdrawal of CBRs.** The Fund's role has included facilitating dialogue among stakeholders, fostering an enhanced understanding of the phenomenon in the context of surveillance and Financial Sector Assessment Programs and providing technical assistance and training to help affected countries enhance their monitoring of CBRs and strengthen their legal, regulatory and supervisory frameworks. To achieve these objectives, the Fund has been collaborating on an ongoing basis with the Financial Stability Board, World Bank, G20, Financial Action Task Force, Arab Monetary Fund, Committee on Payments and Market Infrastructures, and other stakeholders. Going forward, the Fund will continue to support its member countries in addressing issues arising from the withdrawal of CBRs to ensure financial stability and promote financial inclusion.

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## Acronyms and Abbreviations

AC	Active Correspondents
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
AMF	Arab Monetary Fund
BCBS	Basel Committee on Banking Supervision
BSA	Bank Secrecy Act
CARICOM	Caribbean Community
CBR	Correspondent Banking Relationship
CDB	Caribbean Development Bank
CPMI	Committee on Payments and Market Infrastructures
ECCB	Eastern Caribbean Central Bank
FATCA	Foreign Account Tax Compliance Act
FATF	Financial Action Task Force
FCA	Financial Conduct Authority
FinCEN	Financial Crimes Enforcement Network
FIU	Financial Intelligence Unit
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
GFC	Global Financial Crisis
KYC	Know Your Customer
LEI	Legal Entity Identifier
MENA	Middle East and North Africa
MT	Message Types
MTOs	Money Transfer Operators
NPOs	Non-profit Organizations
OFAC	Office of Foreign Assets Control
RDBs	Regional Development Banks
SMP	Staff Monitored Program
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TA	Technical Assistance
UFR	Use of Fund Resources
USD	U.S. Dollar

# INTRODUCTION

1. **A growing concentration of cross-border flows can potentially exacerbate financial fragilities in countries significantly affected by correspondent banking relationship (CBR) withdrawal.** Such flows, including for trade finance and remittances, are important for financial stability and support economic growth and development. So far, these fragilities have had only a limited direct impact, partly because alternative arrangements have been put in place in affected countries. In the longer run, the risks posed by CBR pressures to financial stability, growth, and development prospects may be contained by policy responses and industry initiatives, as well as financial and technological advances.
2. **The factors leading to global banks' withdrawal from CBRs are multiple and interrelated and their relative significance varies across countries.** The withdrawal of CBRs reflects banks' business decisions based on their assessment of the profitability and the risk of the relationships. These decisions have been shaped by the changing regulatory, supervisory, and enforcement environment post-global financial crisis (GFC) and the resulting increases in overall compliance costs. In certain instances, the increased costs and correspondent banks' concerns about their ability to assess and manage CBR risks have led them to terminate their CBRs with specific respondent banks, countries or even regions.
3. **In response to calls from its membership, the Fund has been examining the issue of CBR withdrawal and providing policy advice and capacity development to its members.** The Fund, through its surveillance, Financial Sector Assessment Program (FSAP), and capacity development work has an important role to play in monitoring risks and advising its membership on policies to help tackle adverse consequences from the withdrawal of CBRs. The Fund has collaborated on an ongoing basis with the Financial Stability Board (FSB), World Bank, G20, Financial Action Task Force (FATF), Arab Monetary Fund, Committee on Payments and Market Infrastructures (CPMI), among others, to identify the scale and drivers and assess the impact of the withdrawal of CBRs. A Staff Discussion Note on this issue was published in June 2016 (Erbenova et al., 2016). The Fund held several events to facilitate dialogue among relevant stakeholders to reach a common understanding of the issue and develop shared responses
4. **The purpose of this Board Paper is to offer further considerations on recent trends in CBRs, assess and propose responses to the withdrawal of CBRs, and seek the endorsement of the Board on staff engagement with the membership going forward.** The paper is divided into five sections. The first section describes the role of CBRs, reviews recent trends, and examines the consequences of CBR withdrawal with particular emphasis on remittances. The second section reviews the drivers of CBR withdrawal. The third section discusses ongoing policy responses and industry initiatives to address CBR withdrawal. The fourth section outlines a proposal for Fund's continued role and strengthened staff engagement with the membership on this issue. Finally, the fifth section concludes with issues for discussion.

## CBR—RECENT TRENDS AND CONSEQUENCES

**5. Correspondent banking plays a key role in global trade and economic activity.** CBRs enable the provision of domestic and cross-border payments, including remittances, and support economic growth through international trade and cross-border financial activity. CBRs are a mode of delivery of financial services, which is clearly defined under international trade agreements (World Trade Organization, 1994).

**6. Global banks have selectively withdrawn from the business of correspondent banking since the GFC.**<sup>1</sup> This development generally reflects correspondent banks' assessment of the profitability and risk of the relationships. Factors that have shaped the re-evaluation of business models include changes in the regulatory and enforcement landscape, notably with respect to more rigorous prudential requirements, economic and trade sanctions, anti-money laundering/combating the financing of terrorism (AML/CFT), and tax transparency as well as the resulting increases in compliance costs (Section III).

**7. The pressures on CBRs are accentuating financial fragilities in affected countries by concentrating cross-border flows, which may pose financial stability risks undermining growth and development prospects.** So far, however, the direct economic impact has been largely offset by a number of factors, including by alternative arrangements put in place by financial institutions, especially with regard to trade and remittances corridors. Generally, these alternative arrangements may have resulted in increased costs of remittances in some countries, and the sustainability of these arrangements remains to be seen as they do not necessarily address the underlying drivers of CBR withdrawal. In addition, the observed growing concentration in cross-border flows, in terms of value and volume per active correspondent (AC), may pose financial stability risks for the affected countries.

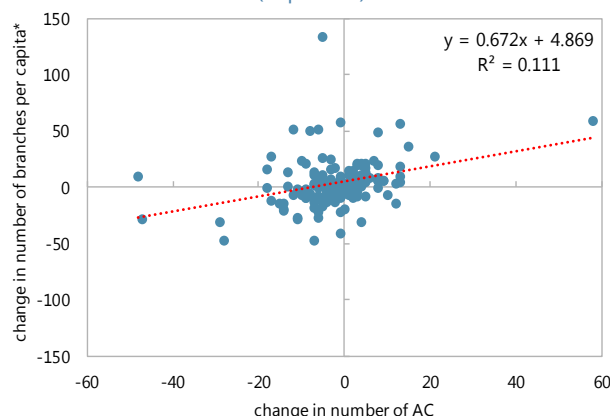
**8. Over time, the loss of CBRs may also negatively impact growth and development prospects.** For example, the number of ACs is typically related to the size of banks' branch networks (Figure 1). While data is insufficient to establish causality, this might imply that a substantial loss in CBRs—typically also associated with other negative developments—may eventually impede prospects for financial inclusion and intermediation. This impact would be magnified if the growth in remittances and trade is curtailed.

<sup>1</sup> This phenomenon is often referred to as "de-risking." The indiscriminate use of the term "de-risking" has confused the dialogue on the trends and drivers of the withdrawal or termination of CBRs (Erbenova, et al., 2016). Accordingly, this paper will refer to the phenomenon of reducing or terminating CBRs as withdrawal of CBRs.



**Figure 1. Correlation Between Changes in Number of ACs and Number of Branches**  
(Growth from 2012 to 2015)

Number of AC vs number of branches per capita, change  
(in percent)



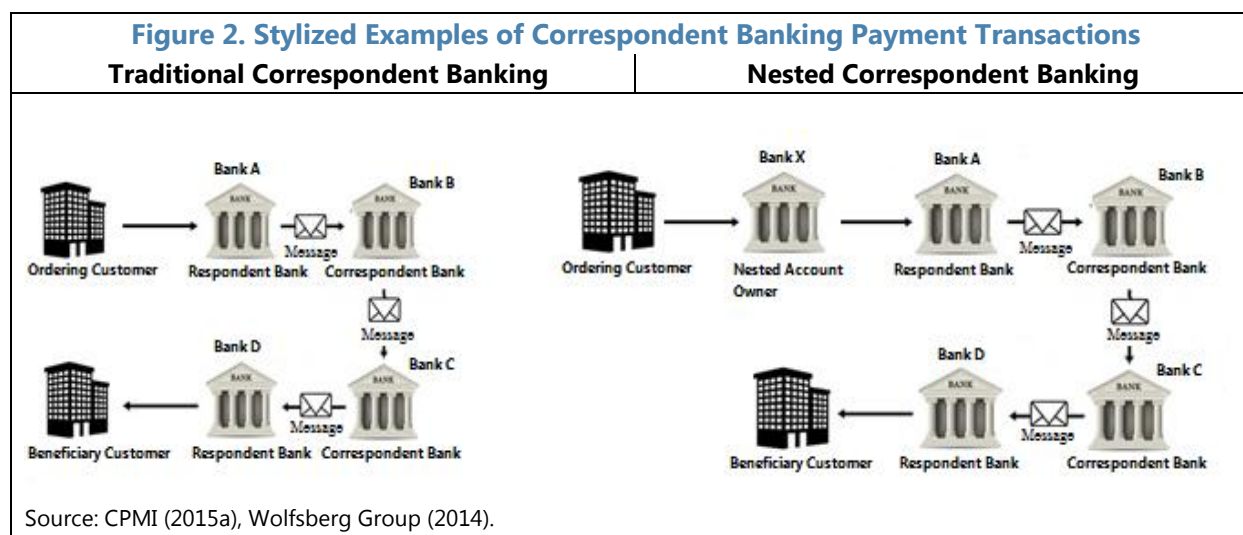
\*Denoted as branches of commercial banks per 100,000 adults.

Source: CPMI (2016). Staff calculations.

## A. Role of CBRs

**9. Correspondent banking consists of a bilateral arrangement, often involving a reciprocal cross-border relationship in multiple currencies.** A correspondent banking arrangement involves one bank (the correspondent) providing a deposit account or other liability account, and related services, to another bank (the respondent), often including its affiliates. The arrangement requires the exchange of messages between banks to settle transactions by crediting and debiting accounts. These messages could be associated with payments, trade finance, foreign exchange, or securities transactions (Annex I).

**10. Correspondent banking services are provided in three main forms (Figure 2).** First, the most traditional form of correspondent banking involves a respondent bank entering into an agreement with a correspondent bank to execute payments on its own behalf and on behalf of its direct customers. Second, nested correspondent banking refers to the use of a CBR by a respondent bank's intermediate customers (e.g., banks and financial institutions), which could then use the relationships for their own clients. Third, payable-through accounts are similar to nested correspondent banking, but in the case of these accounts, the respondent bank allows its intermediate customers to access the correspondent account directly to conduct business on their own behalf.



**11. Banks provide a range of services to direct and intermediate customers through CBRs.**

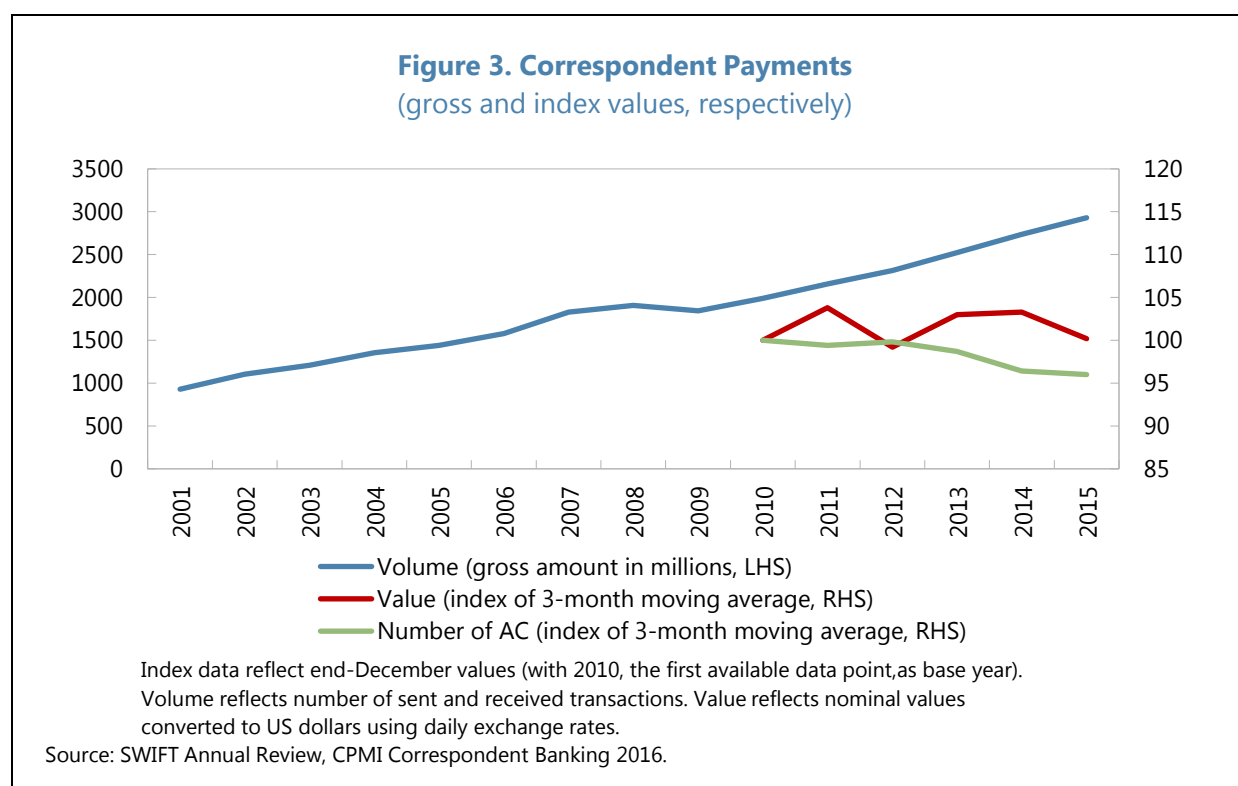
Direct customers can be served by local, regional, or global banks and include individuals, small- and medium-sized enterprises, corporations, and government and public administrations. Intermediate clients are normally served by global banks and include banks and financial institutions, with direct customers of their own. For direct customers, these services include cash management (including payments), trade services, liquidity management, working capital optimization, financial supply chain, and short-term investments. For intermediate clients, services include payment processing, securities/custody, foreign exchange, and information management (International Payments Framework Association, 2011).

**12. CBRs also support payment solutions performed by other financial institutions, including money transfer operators (MTOs).** With respect to remittance flows, CBRs support the channeling of small payments that have generally been aggregated by small financial intermediators. The transfer of remittances involves banks and small financial intermediators (e.g., MTOs). These institutions collect small amounts of remittances and use CBRs to send the aggregate amounts to the account of their counterparts, which will subsequently redistribute the remittances to the beneficiaries.

**13. Cross-border payments have traditionally flowed through large financial centers.** Major CBR flows—both in terms of value and volume (i.e., number of messages)—occur between regions such as North America, Europe, and Asia. Currencies such as the U.S. dollar (USD), euro, British pounds, yen, and renminbi dominate, with USDs accounting for about 50 percent of the transactions (CPMI, 2016), making USD CBRs critical for access to the global financial system.

## B. Recent Trends in CBRs

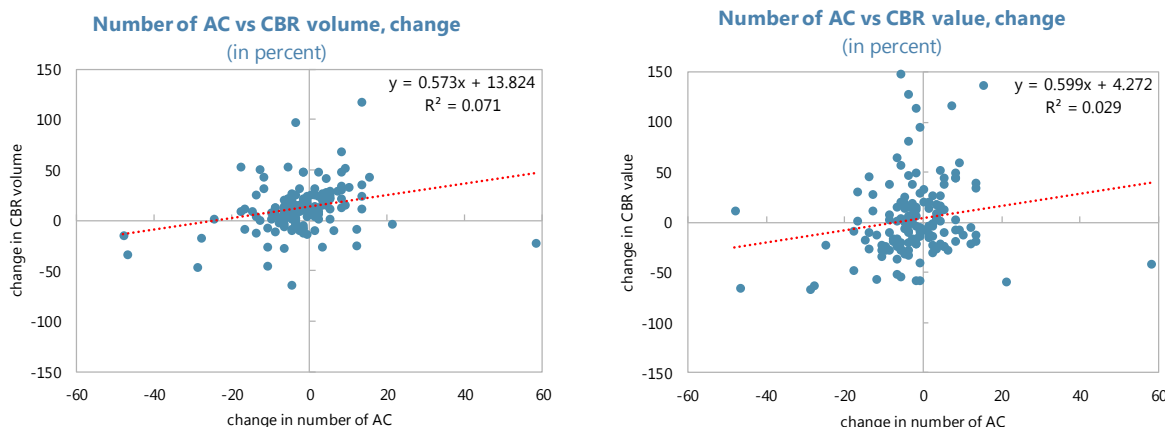
**14. The withdrawal of CBRs during 2012–15 varied significantly across countries.** In general, overall cross-border payments remained stable, and changes in the number of ACs, value, and volume were relatively small for most countries, though some experienced large declines (Figures 3 and 4). In this regard, the USD seems to be the currency most affected by the withdrawal of CBRs, with even non-U.S. licensed correspondent banks increasingly withdrawing from providing services in this currency (CPMI, 2016). Analysis by Fund staff indicates that in 2016 cross-border payments flowing through the largest regional financial centers remained broadly unchanged, and the size of volume and value of payment corridors between them was little affected.



**15. Concentration can be analyzed using the total number of transactions (volume) and total amounts (value) of payment flows.** The size of the total value channeled through the payments corridors relative to the size of the economy may give an indication of total risk. However, because values could be distorted by inflation and exchange rates, volume provides a more stable indicator. In general, while an increase in volume could result in greater efficiency, with greater economies of scale and reduction in unit costs (Cook and Soramäki, 2014), a substantial increase in concentration (for either volume or value) could make counterparties more vulnerable to operational disruptions or failures since payment flows are occurring through a small number of correspondents.

**Figure 4. Correlations between ACs and CBRs Values and Volumes**

*There is a positive, although weak, relationship between the change in ACs and the change in value of CBRs, with significant variation across countries.*



Source: CPMI (2016). Staff calculations.

**16. While the level of pressure on CBRs varies significantly across countries reflecting a complex set of economic, financial and geopolitical concerns, the overall value and volume data show no clear trend in corresponding banking activity (CPMI, 2016).** However, based on median statistics of available CPMI data, the number of ACs and the value of transactions fell during 2012–2015, while the volume of transactions increased (Figures 5 and 6). Taken together, it would appear that concentration increased. CPMI data suggests that fragile states under sanctions or facing civil unrest are among those that have been the most affected across all metrics.<sup>2</sup>

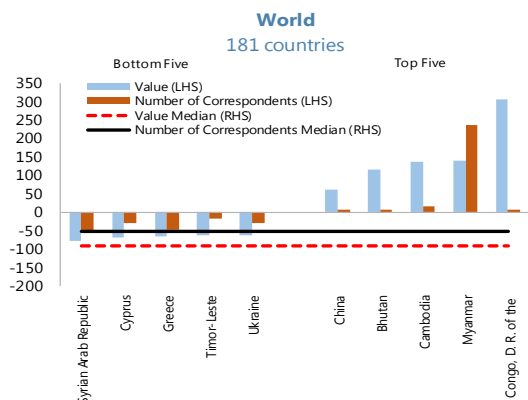
**17. Nonetheless, many countries have indicated that they continue to access the USD payment network through USD CBRs with parent/group related or other intermediary banks.** These alternative arrangements are fragile and may be unavailable for all respondent banks or only applicable to a subset of their clients. These arrangements are less fragile for those branches or subsidiaries of global banks given the generally sound compliance framework of the parent.

<sup>2</sup> However, the results of the analysis have to be interpreted with caution since data does not control for the size of the economy and financial sector. In addition, in some cases the observed decline of CBRs is not necessarily driven by correspondent bank business decisions, but may also be related to regulatory changes and a re-evaluation of respondent banks' business models (e.g., Ireland), specific dynamics regarding respondent bank's parent banks (e.g., Slovak Republic) or the supervisory strategy (e.g., closing of large number of weak banks in Ukraine in the period 2014–15).

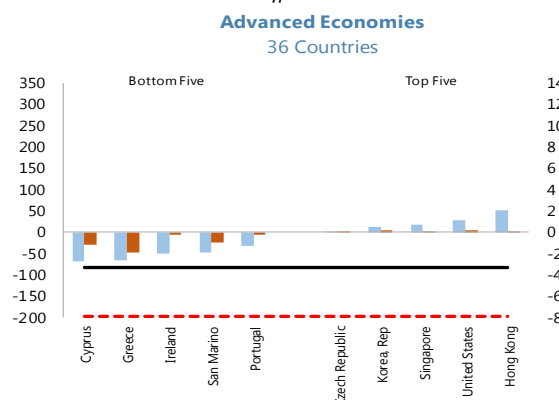
**Figure 5. Value and Number of ACs, 2012–2015 Gains and Losses 1/**  
(in percent)

Based on median statistics, the value of CBR transactions and the number of AC have decreased.

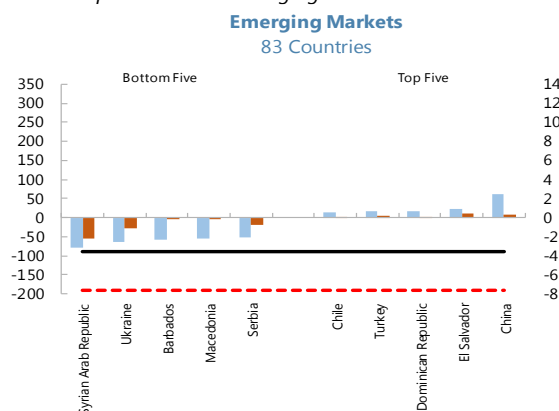
The evolution of ACs and CBR value varies significantly across countries.



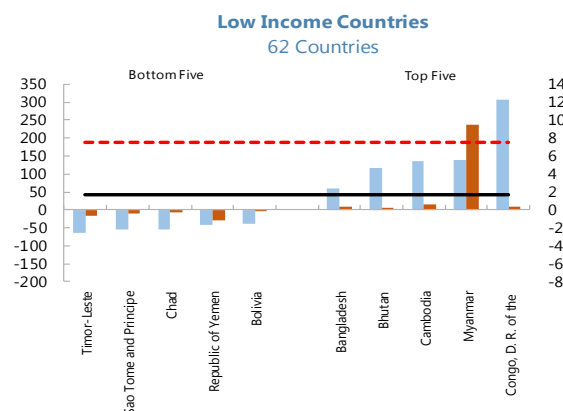
Adverse economic conditions explain to a large extent the observed decline in value in affected advanced countries.



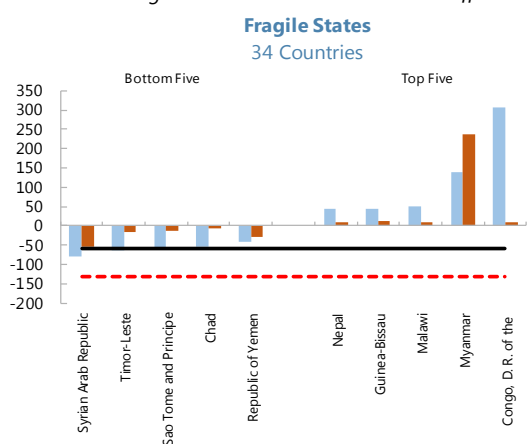
The developments across emerging markets are mixed...



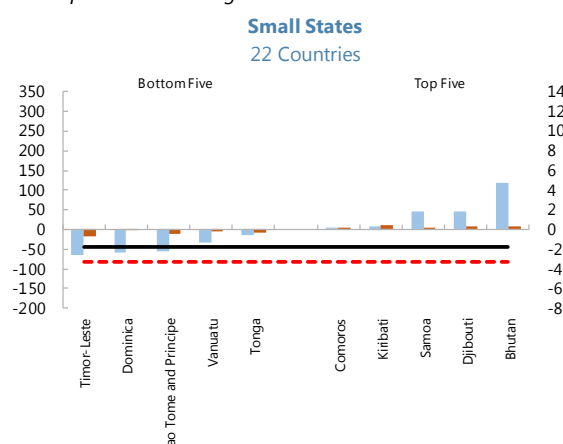
as well as across low income countries...



..... however fragile states under sanctions or facing civil unrest are among those that have been the most affected.



African, Pacific and Caribbean Islands are the small states that have experienced the largest CBR value declines.



Source: CPMI 2016 and IMF staff estimates.

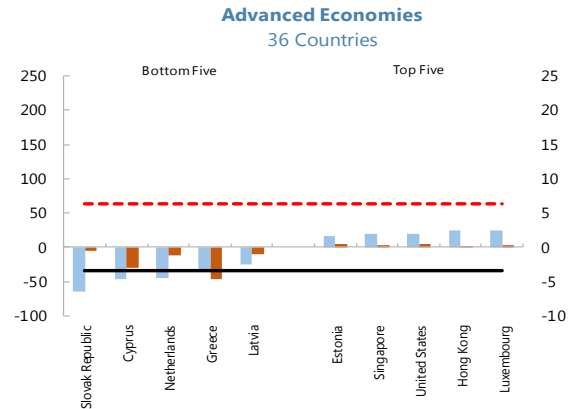
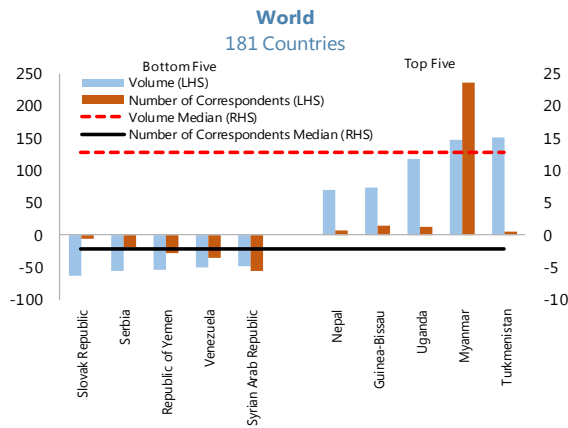
1/ The set reflects countries that had the largest gains and losses in ACs and value.

**Figure 6. Volume and Number of ACs, 2012–2015 Gains and Losses <sup>1/</sup>**  
(in percent)

Based on median statistics, CBR volume increased and the number of AC decreased, suggesting increased concentration.

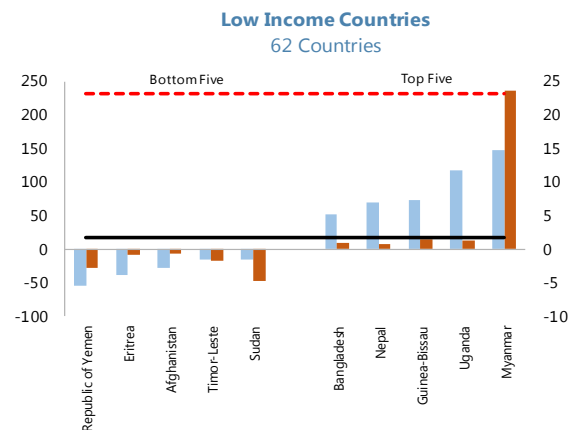
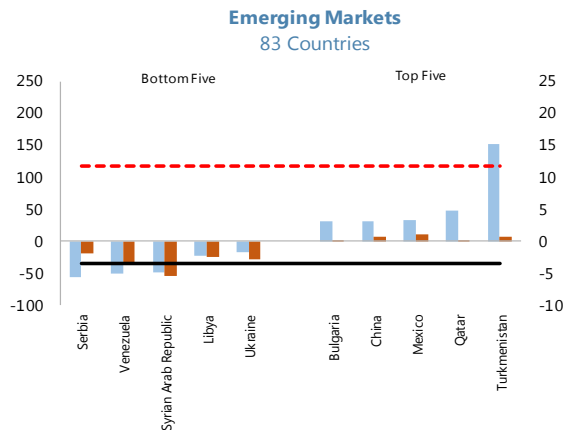
*Evolution of ACs and CBR volume varies significantly across countries.*

*Adverse economic conditions and country specific factors play a role in observed declines in advanced countries.*



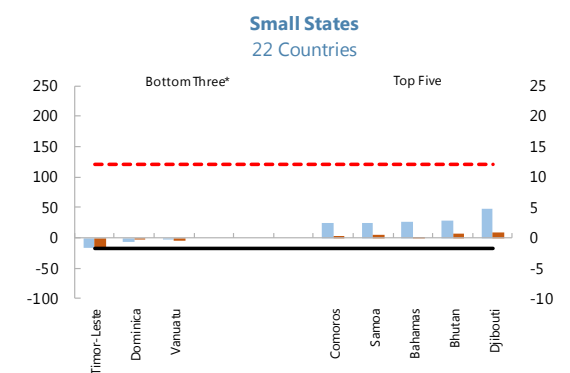
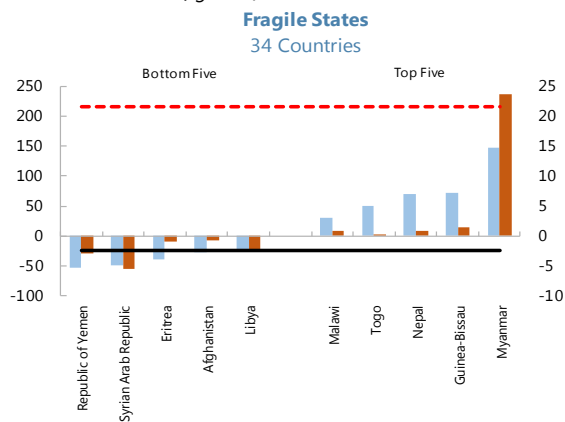
*Although developments across emerging markets are mixed...*

*as well as across low income countries...*



*...fragile states under sanctions or facing civil unrest are among those that have been the most affected (more pronounced than in figure 5).*

*Pacific and Caribbean islands are the small states that experienced the largest declines in the CBR volume.*



\*Only three countries in the sample had negative changes both in volume and number of AC.

Source: CPMI 2016 and IMF staff estimates.

1/ The set reflects countries that had the largest gains and losses in ACs and volume.

## C. Consequences of CBR Withdrawal—Recent Country Experiences

**18. There are multiple macro-financial channels that could be affected by a withdrawal of CBRs.** Pressures on CBRs could disrupt financial services and cross-border flows, including trade finance, remittances, and aid flows, thereby potentially undermining financial stability, inclusion, growth, and development goals. On financial inclusion, for example, a recent survey (Eckert, Guinane, and Hall, 2017) indicates that two-thirds of non-profit organizations (NPOs), which are considered categorically high risk, are experiencing banking problems, including delays of wire transfers, increased fees, account closures, and refusal to open accounts. Many of these NPOs attribute problems with wire transfers to correspondent banking issues. Moreover, loss of CBRs could have an impact on the availability of banks' funding from foreign sources and their ability to provide foreign currency loans for trade finance and/or service their foreign currency denominated debt, compounding existing bank vulnerabilities. Rating agencies have also started to factor in CBR withdrawal as a reason for financial institution rating downgrades (Moody's 2016a, b). The magnitude and the impact of CBR withdrawal could vary from country to country, depending on whether it is a result of a gradual re-evaluation of banks' business models versus a more sudden event (sanctions or civil unrest).

**19. Perception-based surveys conducted in 2015 and 2016 indicate that the withdrawal of CBRs has particularly affected certain regional pockets.** These surveys vary in terms of methodology, scope, period, regional focus, and category of respondents (local or international banks, and banking supervisors). While the surveys have limitations (e.g., response rate, respondent bias), they have provided useful insights into recent trends in correspondent banking. The World Bank conducted a survey of banking authorities, local/regional banks, and large international banks and found that the overall trend in CBRs was not uniform across countries. Responses indicated a withdrawal of CBRs in certain regions of the world, with the Caribbean identified as the most severely affected. In addition, responses from banking authorities pointed to a decline in CBRs in small countries with low volumes of transactions, particularly in Europe and Central Asia, the Caribbean, Africa (World Bank 2015a, 2015b), and the Pacific Islands, where countries such as Fiji, Tonga, and Vanuatu, have also experienced increased costs for remittance transfers (IMF, 2017) (see Annex II). Regional surveys seem to reinforce the finding that pressure on CBRs is more prominent in some parts of the world, although so far, most respondent banks that have lost CBRs were able to find replacement CBRs or rely on alternative arrangements. These regional surveys have included those by the Caribbean Association of Banks and the Association of Supervisors of Banks of the Americas (ASBA 2016), the Arab Monetary Fund, IMF and World Bank survey of Arab banks (AMF, IMF, WB 2016), and the IMF and the Union of Arab Banks survey (IMF, UAB 2015).

**20. Staff assessments in the context of Article IV consultations indicate that CBR pressures have so far had a direct impact on only a limited number of countries' financial systems (Box 1).** The withdrawal of CBRs has been discussed in 49 Article IV consultations between 2015 and 2016. The coverage of CBR issues across Article IV consultations, where this issue was deemed macrocritical or where discussion was agreed with the authorities, highlights similar regional pockets of CBR withdrawal as identified in the surveys, namely in the Caribbean, the small islands of the Pacific, the Middle East and North Africa (MENA) region, Central Asia, and Africa. Due to a lack of

quantitative data, staff discussions were mainly based on a qualitative assessment of the impact of CBR withdrawal on a country's financial system (Box 2). Of these, staff found that CBR withdrawal has had a moderate or no significant impact on the financial system in 23 countries, and an adverse impact in 4 countries. In Belize, staff assessed that the loss of CBRs has "taken systemic proportions," with even its central bank reportedly being affected. No country team quantified a macro-economic impact, but several stressed the need for careful monitoring as a more significant loss of CBRs could have negative implications for the economy in the future. In addition, in the context of the U.S. Article IV, staff conducted a survey of global banks, which revealed that while the number of CBRs has been declining, there were indications that the volume of correspondent activity continues to rise. However, a number of country reports have raised concerns about potential significant implications in the future on remittances and general financial inclusion, if the withdrawal trends were to continue.

### Box 1. The Withdrawal of CBRs—Assessment in Staff Reports

The Impact of the Withdrawal of CBRs	
No significant impact/moderate impact	The Bahamas, Barbados, Costa Rica, Cyprus, Grenada, Guatemala, St. Lucia, Tonga, El Salvador, Guyana, Jamaica, Kiribati, Kuwait, Lebanon, Morocco, Panama, Samoa, Saudi Arabia, Solomon Islands, Sri Lanka, St. Kitts and Nevis, St. Vincent and the Grenadines, and the United Arab Emirates.
Adverse impact	Belize, Iran, Liberia, and Sudan.
The Quantification of the Loss of Business in Respondent Banks	
The Bahamas	Six institutions, representing a small share of total about 19 percent of banking system assets, have recently lost CBRs.
Belize	Only 2 of the 10 domestic and international banks have CBRs with full banking services. The Central Bank of Belize lost three CBRs.
Liberia	All commercial banks have lost at least one CBR in the last 3 years, with the most affected losing about 78 percent of their CBR accounts (SIP).
Panama	The total number of CBRs remained stable at 463–464 between March 2015 and End-February 2016 (62 relationships were lost, but Panamanian banks managed to establish 63 new relationships).
Sudan	Sudan lost almost half of its CBRs between 2012 and 2015.

Source: Article IV staff reports.

### Box 2. The Withdrawal of CBRs: Selected Cases

The Bahamas, Belize, Kuwait, Lebanon, Liberia, Morocco, Panama, and Samoa, and West Bank and Gaza are examples of jurisdictions that had either experienced CBR withdrawal and were taking action to mitigate the impact, or where the authorities had taken preemptive action to address the risks of CBR withdrawal.

#### The Bahamas

**In The Bahamas, 6 institutions, mainly and standalone international banks and a few domestic commercial banks, together representing a small share of total banking system assets, had recently lost CBRs.** All of them had additional CBRs, found replacements, or were able to negotiate a continuation in service (including against an additional annual fee). Canadian banks and other international banks maintained direct or indirect access to USD CBRs as they are able to rely on the sound AML/CFT frameworks in place across the group as a whole. MTOs had also been affected. One domestic bank had closed its Western Union money transfer franchise in summer 2015, while another MTO provider had been notified



**Box 2. The Withdrawal of CBRs: Selected Cases (continued)**

about a possible termination of its banking relationship. Adverse impacts on bank operations had been reflected mainly in prolonged clearance procedures and higher investment and staffing costs stemming from additional reporting requirements and scrutiny. Business segments that had been affected include credit card payments, cash management services, investment services, clearing and settlement, international wire transfers, and remittance services. In addition to engaging with regional stakeholders, authorities had been strengthening their overall risk-based framework for regulation and supervision, and the Central Bank of The Bahamas had finalized amendments to its AML/CFT Guidelines and introduced new wire transfer regulations.

**Belize**

**In Belize, the loss of CBRs experienced by the largest banks had been posing significant challenges for the economy.** At some point, only 2 of the 10 domestic and international banks had CBRs with full banking services. A systemic bank and its international subsidiary could process only non-USD wire transfers. Other banks had also managed to maintain wire transfer arrangements, including with non-bank providers of payment services. Four banks, including the systemic bank, had also lost their credit card settlement accounts with a small bank in New York, and proceeds from their credit card transactions could only be used through their accounts with a major credit card company or through restricted accounts such as brokerage accounts. The Central Bank of Belize had lost three of its five CBRs in the last two years. On aggregate, the impact of the loss of CBRs on volumes of international transactions was not yet noticeable based on available data as most CBRs were actually lost in late 2015 or early 2016, but there were indications that transaction costs were increasing. For example, one of the larger banks increased wire transfer fees from about US\$100 to US\$300. The processing time of wire transfers had increased from “within 24 hours” to “several days.” The growth rate of deposits in the banking system had fallen, driven by a significant decrease in deposits in international banks, partially offset by an increase of deposits in domestic banks. However, domestic banks had put in place alternative arrangements, including replacing CBRs.

**The authorities had been engaging with regional stakeholders and analyzing the pros and cons of potential solutions.** These included (i) collective action to increase the business volume brought to a smaller number of correspondent banks; (ii) introduction of a scheme to purchase CBR insurance policies; (iii) creation of a U.S.-licensed special purpose vehicle to process international transactions; and (iv) payment of higher CBR service fees.

**Kuwait**

**Kuwaiti banks had not faced CBR withdrawal.** However, to avoid the perception of risk that could prompt global banks to cut relations, several domestic banks had preemptively severed links with some domestic charities and foreign exchange houses. The Central Bank of Kuwait had been actively participating in international forums aimed at clarifying supervisor requirements in home jurisdictions of correspondent banks, maintaining open channels of communication between domestic and foreign banks and regulators.

**Lebanon**

**CBR withdrawal could hurt cross-border payments, trade finance, and remittances.** A few foreign banks had severed business relationships with a few smaller Lebanese banks owing to measures introduced by foreign governments with regard to ML/TF concerns. The authorities have continued to strengthen the AML/CTF regulatory environment and risk assessment framework, and to address identified gaps with regards to international tax compliance and exchange of information.

**Liberia**

**Liberia had experienced a broad-based withdrawal of CBRs.** All commercial banks had lost at least one CBR since 2013. Ten global banks had terminated about 48 percent of CBRs (36 out of 75), with the banks experiencing the highest impact having lost 78 percent of CBRs, compared to the banking system average of 46 percent. The advance notice provided for severing the relationship had narrowed from six months to overnight. The loss of CBRs was not unique to commercial banks as the Central Bank of Liberia also had

**Box 2. The Withdrawal of CBRs: Selected Cases (continued)**

some of its CBRs terminated in March 2014. Addressing deficiencies in the AML/CFT framework would have strengthened the case for containing the loss of CBRs and even reinstating some CBRs. To address gaps within the current AML/CFT framework, a dedicated unit had been set up at the central bank.

**Morocco**

**The risk of a loss of CBRs was highlighted in the Risk Assessment Matrix in Morocco's 2016 Article IV Staff Report.** While the likelihood of the risk was assessed to be high (for USD flows), the anticipated impact was assessed to be low (as most cross-border payments are in euro rather than USD).

**Panama**

**In Panama, changes in capital regulations in source countries, concerns over compliance with tax rules and international standards on financial sector integrity, and increased due diligence by foreign banks, particularly with links to the U.S., had curtailed some smaller Panamanian banks' access to correspondent banks.** The total number of CBRs had remained stable at 463–464 between March 2015 and end-February 2016, as 62 relationships had been lost, while Panamanian banks had managed to establish 63 new relationships. Notwithstanding that, stress testing the impact of a large-scale loss of CBRs on the availability of funding from foreign banks and depositors showed some liquidity problems in the aftermath of a severe loss of CBRs and, hence, foreign-sourced funding might have spilled over to solvency in the medium run, as funding costs might have risen and fee income could have fallen.

**The authorities were taking action to mitigate the impact.** In particular, they were strengthening banking regulatory and supervisory framework and expanding their supervisory coverage to include other financial entities, such as leasing and factoring companies, financial cooperatives, fund-remittance companies and debit and credit card companies, as required by the new AML/CFT legislation. Moreover, cooperation with other supervisors in the region had been considerably strengthened to enhance the enforcement of AML/CFT standards.

**Samoa**

**To maintain their CBRs, respondent banks had been withdrawing from providing banking services to MTOs, increasing the fragility of the remittances sector, which is also likely to increase the cost of remittances.** Remittances amounted to approximately 18 percent of GDP of which about 80 percent were channeled through MTOs. The Samoan authorities have taken important steps to address the phenomenon, including active engagement with global stakeholders. Recent publication of the national AML/CFT strategy was an important step. The authorities were committed to establish a database, which can help facilitate remittances by enhancing compliance.

**West Bank and Gaza (WBG)**

**At the time of the report, a global bank had begun limiting its correspondent banking services to Palestinian banks as part of its regional "derisking" strategy, although given its small presence this does not appear to have had a significant impact.** Citing AML/CFT concerns, Israeli banks continue to warn of, but have yet to act on, plans to terminate correspondent services with Palestinian banks. To prevent that, the Israeli authorities have put in place temporary financial and judicial assurance to help preserve Israeli-Palestinian CBRs. Ongoing threats to Israeli-Palestinian correspondent banking relations, if realized, could undermine the payment system, increase cash-based transactions, weaken trade, and erode the tax base. Terminating CBRs could have severe consequences given the central role of the shekel in WBG and the economic ties with Israel via trade, employment, and remittances. The Palestinian authorities are working vigorously to prevent that, with efforts centered on bringing WBG's AML/CFT regime in line with international standards.

Source: Article IV staff reports, West Bank and Gaza, Report to the Ad Hoc Liaison Committee, bilateral discussions with respondent banks.

**21. The Article IV discussions suggest that the pressures on CBRs are accentuating financial fragilities.** Most countries, even some that did not report a decline in CBRs, expressed concern about an increase in the cost, processing time and/or scrutiny of these relationships. This could have implications for productivity and cost of doing business, or on the scope of financial services provided. There may also be market structure implications, as indigenous and smaller banks in general appear to be more affected by CBR withdrawal than foreign-owned banks. Offshore banks have also been highlighted on a couple of occasions as being more vulnerable to losing access to CBRs. Beyond correspondent banking, staff discussions often found that certain categories of customers were experiencing increased scrutiny and, at times, account closures as a result of pressure from CBRs. This is particularly the case of MTOs, although other categories of customers identified in staff discussions have included charities, foreign exchange houses, online gaming, and offshore businesses.

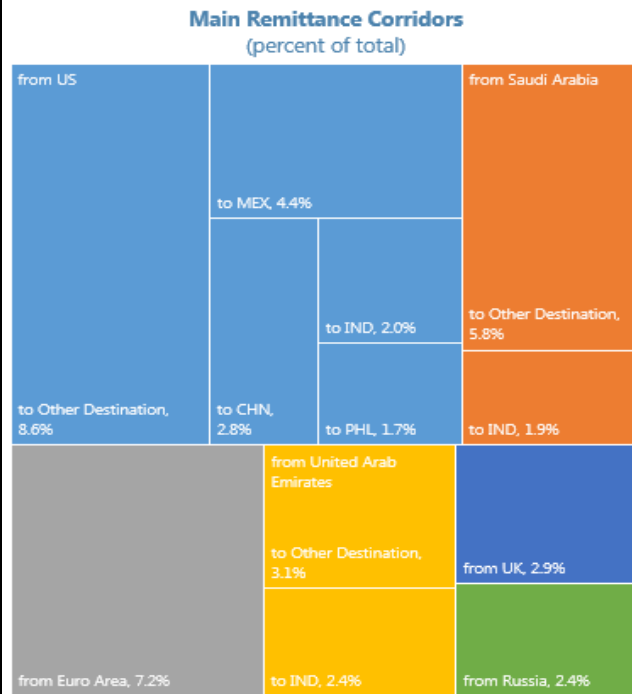
**22. Further significant increases in concentration of trade and remittance corridors could pose risks to financial stability in affected countries.** In 1 out of 5 countries (mainly emerging and developing economies), remittances represent close to 10 percent of GDP (Figure 7). Such remittances inflows, which are usually channeled through banks and MTOs, are strongly concentrated in a few major corridors. Decreased access of MTOs to the banking system could pose financial stability risk to these countries and significantly affect financial inclusion and development (see country vulnerability matrix in Annex III). In addition, some of the bank-facilitated payment flows related to trade may already have moved into other payment instruments. These include the use of open accounts, cash-in-advance, letters of credit, and documentary collections (Niepmann and Schmidt-Eisenlohr, 2013). Africa's trade with China may be a case in point. Although Africa's trade with the U.S. has declined (due to the fall of Nigerian exports), payment flows have increased. This is largely due to the increase in Sino-Africa trade, which is U.S. dollar-denominated and channeled through U.S. banks. Moreover, Sino-Africa trade relies largely on the use of risk-mitigating trade finance tools such as letters of credit and documentary collections rather than the use of single customer credit transfers for payments (Sy and Wang, 2016).

**23. A growing concentration in cross-border flows could also undermine growth and development prospects.** Even if it is possible to redirect remittances via alternative channels, generally this has come at a higher cost and a reduced scope of services and resulted in higher market concentration (Box 3 and Figure 8). The exit of MTOs from the market could also significantly reduce adequate financial services coverage in remote and rural areas. In addition, the search for low-cost replacement of MTOs could push remittances to informal channels, which would reduce the authorities' and banks' ability to monitor and investigate transactions.

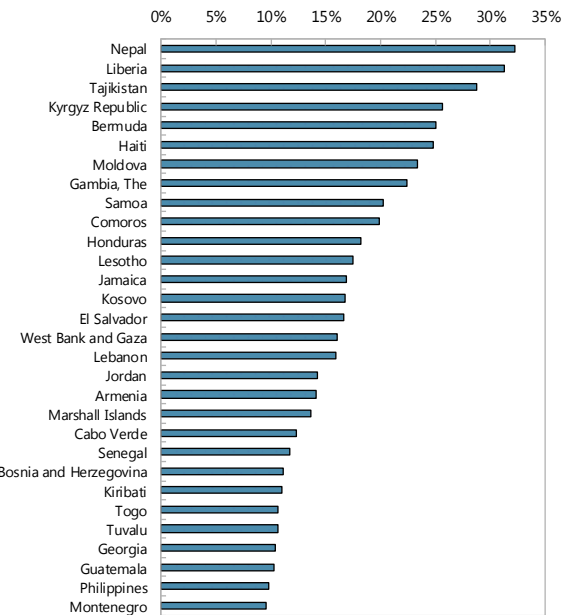
**Figure 7. Remittances' Corridors**

While the strong concentration of remittance flows to a few major corridors might in some circumstances increase global systemic risk ...

... small remittance corridors could be equally important in transmitting disturbances to individual countries.



Source: World Bank Migration and Remittances Database.

**High Remittance Inflow Countries**  
(percent of GDP)

Source: World Bank Migration and Remittances Database. Country sample restricted by availability in the combined database (CPMI 2016, World Bank Remittances Prices Worldwide, World Bank Migration and Remittances Database) used in the analysis.

**Figure 8. Correlation between Changes in the Number of ACs, Costs and Remittances**  
(Growth from 2012 to 2015)

While transfer costs seem to correlate with the changes in number of active CBRs, remittance flows are affected much less.



Source: Staff calculations based on CPMI 2016, World Bank Remittances Prices Worldwide, World Bank Migration and Remittances Database.

### Box 3. Trends in the Costs of Remittances 1/

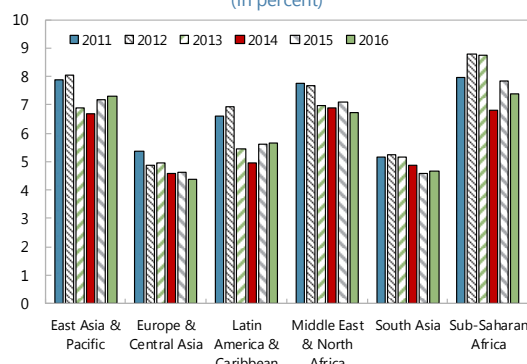
**After following a downward trend in the beginning of the decade, the average cost of remittances has increased moderately in recent years, but still remains well below 2011.** With the closure of MTO

bank accounts becoming more pronounced since 2014, remittances are increasingly transferred using more expensive services of banks or other nonbank financial institutions, raising the average cost of remittances. While the average cost at the global level declined from 6.6 percent in 2011 to 5.7 percent in 2014, it has risen to 6 percent overall since then.

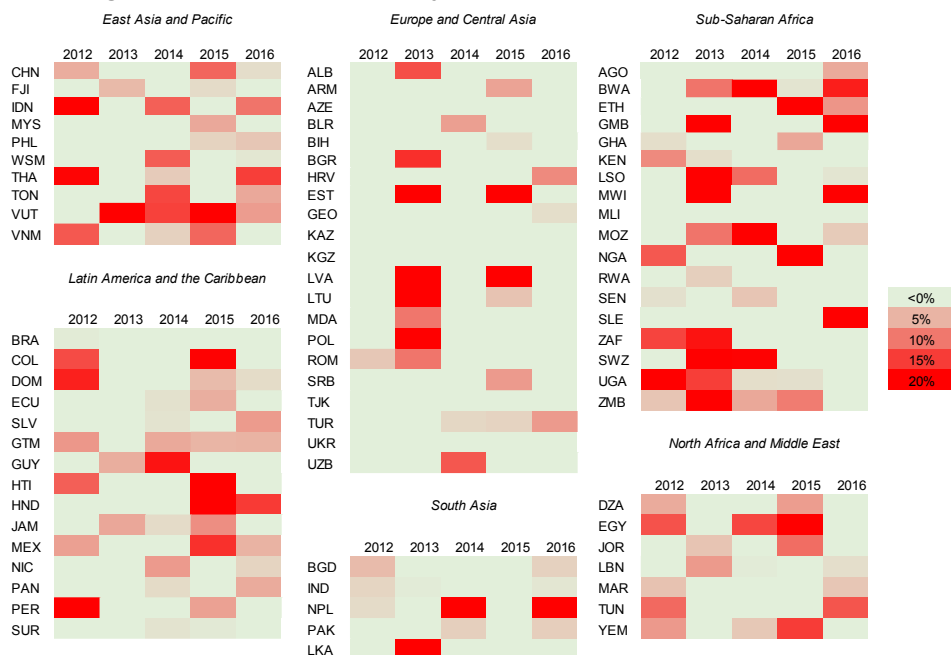
**The recent increase in costs of remittances was most pronounced in the regions of East Asia and Pacific, Latin America and the Caribbean, Middle East and North Africa, and Sub-Saharan Africa** (see heat map). The increase in the costs of remittances remained

modest in most countries, with some notable exceptions. Costs have been clearly trending upwards in several countries since 2014, including countries in the Pacific (Samoa, Vanuatu), East Asia (China, Vietnam), Central America (El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama), South Europe (Turkey), and the Middle East (Egypt, Jordan). In 2015, when the rise in costs was the strongest, 5 percent of all countries in the sample experienced an increase in costs higher than 30 percent, implying an additional fee of more than US\$2 on a US\$100 transfer. At the same time, in most cases, the initial increase in fees did not last and was followed by a period of decline, offsetting the initial adverse impact on remittances. The fact that remittances costs resumed their downward trend observed before 2014 might reflect the importance of continued financial innovation in determining the evolution of transfer costs.

**Cost of Remittances by Destination Region<sup>1</sup>**  
(in percent)



#### Change in Cost of Remittances by Recipient Countries (2012–2016 Q3)



1/ Staff calculations based on WB Remittance Prices Worldwide database. Costs of transfer of USD 200, in less than an hour. Fixed sample composition. Weighted across source countries using bilateral remittance values. Country sample restricted by availability in the combined database (CPMI 2016, World Bank Remittances Prices Worldwide, World Bank Migration and Remittances Database) used in the analysis.

## DRIVERS OF THE WITHDRAWAL OF CBRs

**24. While the factors leading to global banks' withdrawal from correspondent banking are multiple and interrelated, these are ultimately individual business decisions.** These decisions are driven by banks' assessment of the risks and profitability of the CBR. While the profitability of the relationship is a function of income, cost and capital, the correspondent bank's risk assessment takes into consideration the risks of a specific relationship and the institution's own risk tolerance. These factors operate concurrently and their relative significance varies case-by-case.

**25. This is broadly in line with staff's discussions with global banks and regulators held in the context of Article IV consultations and FSAPs.** The main drivers identified in the U.S. 2016 Article IV included a broader realignment of banks' business models, increasing economic, financial and reputational risks, tighter post-crisis regulation, broader reporting requirements (including those related to AML/CFT) and conflict of regulations such as those arising from data privacy constraints on cross-border information sharing that prevented U.S.-based banks from undertaking the needed due diligence with their foreign bank clients. In the Germany FSAP, staff noted that the withdrawal of CBRs by German banks appeared to have been driven mainly by business and risk-return considerations, lower risk appetite, and the implementation of a risk-based approach under international standards. The U.K. FSAP alluded to the implementation of the international post-crisis reform agenda and national initiatives as having implications for CBRs and for the provision of financial services by U.K. banks to certain categories of customers, notably MTOs and NPOs.

### A. Profitability Considerations

**26. High-volume, low-return, and balance-sheet-intensive business lines, such as correspondent banking, have become less attractive in the post-GFC macroeconomic environment.** Macroeconomic conditions are putting pressure on banks' profitability. Since the GFC, there has been a shift from direct cross-border lending to local lending by foreign banks' affiliates, with global banks refocusing their activities on some key markets (IMF 2015). Global regulatory reforms have entailed a significant increase in banks' capital requirements compared to pre-crisis levels, raising the cost of capital. The post-GFC environment of surplus liquidity and low interest rates has compressed margins and made correspondent banking, which is a low-margin business, less profitable by reducing the interest earned from respondent banks' balances.

**27. Increasing compliance costs also weigh on the profit margins of correspondent banks.** Surveys indicate that compliance costs have been increasing with changes in the regulatory landscape over the past 15 years and are likely to contribute to global banks' decision to withdraw from correspondent banking (KPMG 2014a; ECB 2015; World Bank 2015a). This notably stems from the implementation and increasingly active enforcement of AML/CFT requirements, expanding

international and bilateral economic and trade sanctions regimes that banks must comply with,<sup>3</sup> and emerging tax transparency initiatives.<sup>4</sup> Compliance costs are also affected by the efficiency of compliance screening and risk management. These factors, coupled with the absence of sufficient business volume, have affected banks' ability to realize economies of scale, contributing to their decisions to withdraw from CBRs in small states and with small respondent banks.

**28. Compliance costs could further increase as a result of measures aimed at safeguarding against cyber risks.** Cyber risks are a major source of systemic risks and have the potential to affect the broader economy (Depository Trust and Clearing Corporation, 2016). Following high profile incidents, there have been efforts by the public and private sector to strengthen cyber resiliency both at the international and domestic level.<sup>5</sup> The private sector has also responded with the introduction of mandatory customer security requirements and an associated assurance framework by SWIFT. This would require the company's customers to provide detailed self-attestation against mandatory controls from the second quarter of 2017, with enforcement of mandatory controls starting from January 2018.

## B. Risk Assessment Considerations

**29. There are two main factors that a correspondent bank takes into account when assessing the risks it faces.** These factors are the correspondent bank's own risk tolerance and the bank's perception and assessment of the actual risks, including its ability to manage those risks. The correspondent bank's own risk tolerance is informed by: (i) the extent it considers that regulatory expectations are consistent and clear; (ii) its implementation of the risk-based approach under the AML/CFT standard; and (iii) its perception of the high-profile enforcement actions and remedial supervisory actions.

<sup>3</sup> For instance, since the late 1992, the UN Security Council has been adopting an increasing number of targeted financial sanctions involving targeted asset freezes mostly related to counter-terrorism and non-proliferation of weapons of mass destruction.

<sup>4</sup> These initiatives are particularly relevant for offshore financial centers and include (i) multilateral initiatives to "blacklist" countries for regulatory or supervisory deficiencies or for lack of cooperation adopted by the FATF and the Organization for Economic Co-operation and Development's Global Forum on Transparency and Exchange of Information for Tax Purposes (<http://www.oecd.org/tax/transparency/>); and (ii) bilateral initiatives to increase exchange of tax information and transparency of legal entities and to fight tax crimes (e.g., the U.S. Foreign Account Tax Compliance Act, the EU savings tax directive, and France's blacklist of tax havens).

<sup>5</sup> The Committee on Payments and Market Infrastructures-International Organization of Securities Commissions (CPMI-IOSCO) has set guidelines to enhance cyber resilience for financial market infrastructures to safeguard financial stability (CPMI-IOSCO, 2016). Some financial regulators have also proposed regulation, which would require the notification of any material data breach within 72 hours of cyber events and investment in cyber protection (among others) (New York State Department of Financial Services, 2016).



## **Risk Tolerance**

**30. Despite the recent intensified efforts by home jurisdiction regulators to clarify the scope of customer due diligence requirements, some global banks remain concerned about the clarity and consistency of regulatory expectations.** More recently, regulators in key financial centers have made significant efforts to place information on regulations and enforcement actions into the public domain to facilitate banks' assessment of their exposure to compliance risk. Consultation with global banks over the past year indicated a range of views particularly on the clarity of U.S. regulatory expectations and more specifically the need to conduct due diligence on a customer's customer (also referred to as "know your customer's customer"). Some of these banks still found regulatory expectations to be unclear, inconsistently communicated, unevenly implemented by individual examiners, or not well understood. They noted that uncertainty as to whether regulatory expectations have been met could result in an overcautious use of enhanced due diligence by banks to shield from potential supervisory or enforcement actions. This has also had an impact on banks' risk tolerance and in some instances, led to the banks' decisions to terminate certain types of CBRs. In this context, some banks appear to be looking for regulatory certainty (rather than clarity).

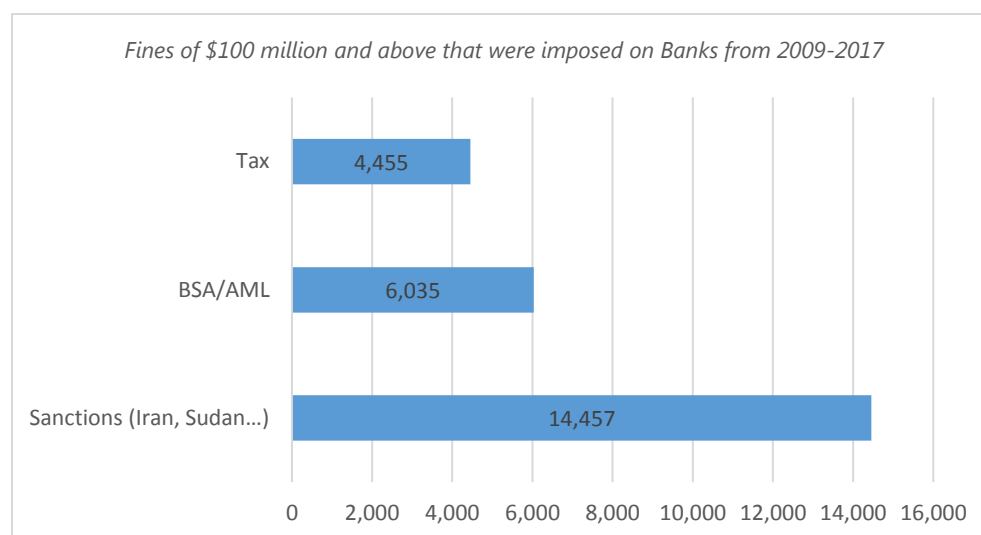
**31. The proper and proportionate implementation of the risk-based approach including under the AML/CFT standard may lead to instances of CBR withdrawal.** For instance, on a case-by-case basis, where a correspondent bank is unable to conduct the required level of customer due diligence to mitigate the risks identified, or where it has reason to believe that the respondent bank is involved in money laundering or terrorist financing activities, it may choose to or, in some cases, be required to terminate the CBR with the respondent bank. In addition, depending on the regulatory requirements of the correspondent bank's jurisdiction, suspicion of fraudulent activity by the respondent bank or its customers (for example, tax evasion, fraud, or corruption) may also call for the termination of CBRs.

**32. High-profile enforcement actions across the financial services industry, particularly a few years ago, may also have influenced banks' risk appetite.** Penalties imposed by the U.S. authorities, and to a lesser extent by the EU authorities, for misconduct and/or criminal behaviors of banks have raised awareness about the potential size of settlements and fines and reputational risks (Figure 9).<sup>6</sup> This may have contributed to shaping global banks' risk appetite, even though high profile enforcement actions have involved institutions demonstrating a sustained pattern of serious violations or intentional evasion of sanctions over a period of years. In particular, the possibility of having their U.S. license revoked, jeopardizing their ability to clear USD, and the introduction of personal liability of bank managers in key jurisdictions (including in the U.S. and in the U.K.) may have affected global banks' risk tolerance to compliance and reputation risk.

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<sup>6</sup> Most large fines for misconduct related to customer due diligence have been levied for breach of the U.S. economic and trade sanctions framework.



**Figure 9. Breakdown of Fines paid by Breach (in Millions of USD)**

Source: Key Financial Center Supervisors and Enforcement Agencies and IMF Staff calculations.

**33. Remedial actions voluntarily undertaken by banks in lieu of enforcement actions have also contributed to shaping global banks' perceptions of regulatory expectations and risk tolerance related to CBRs.** In the U.S. 2016 Article IV, regulators noted the increased use of consent orders by U.S. supervisors and the Department of Justice and the broad intentions to resolve violations with remedial measures taken by financial institutions. For global banks that have entered into non-prosecution<sup>7</sup> and deferred prosecution<sup>8</sup> agreements by the U.S. Department of Justice, these remedial actions are voluntarily agreed to and may go beyond regulatory requirements. The *U.S. Joint Fact Sheet on Foreign Correspondent Banking: Approach to the Bank Secrecy Act (BSA)/AML and Office of Foreign Assets Control (OFAC) Sanctions Supervision and Enforcement* indicates that "the vast majority (about 95 percent) of BSA/OFAC compliance deficiencies identified by the Financial Service Authorities, FinCEN, and OFAC are corrected by the institution's management without the need for any enforcement action or penalty" (U.S. Treasury, et al., 2016). While these agreements are not intended as normative instruments, some global banks have indicated that they have looked to these agreements for greater clarity on the level of compliance expected of them and indicators of what is considered "higher risk" by the authorities, given the complexity of the sanctions regime or the uncertainty about its implementation. As such, they have had an impact on the particular bank's risk tolerance policies. Accordingly, these agreements appear to have contributed to shape some banks' perceptions of de facto regulatory expectations and have, in

<sup>7</sup> These agreements are entered into in circumstances where an authority agrees not to pursue an enforcement action against a cooperator if the individual or company agrees to cooperate fully and truthfully and comply with express undertakings.

<sup>8</sup> Under these agreements, the authorities agree to forego an enforcement action against a cooperator if the individual or company agrees to cooperate fully and truthfully and comply with express prohibitions and undertakings during a period of deferred prosecution.

some cases, affected their approach to maintaining or scaling back CBRs in certain regions or countries or with certain categories of customers (Artingstall et al., 2016).

### ***Risks Associated with a Specific CBR***

**34. In assessing the risks associated with a specific CBR, a correspondent bank takes into consideration the risk environment, and a respondent bank's size, customer base, business model, ownership and control structure, and the effectiveness of its compliance framework.<sup>9</sup>**

This assessment includes the level of risk in a specific country or region, including with respect to corruption, tax evasion, fraud, and money laundering and terrorism financing. For instance, where the respondent bank provides services to categories of customers associated with higher risks of money laundering or terrorist financing,<sup>10</sup> correspondent banks may require enhanced due diligence on the part of respondent banks. Correspondent banks attach great importance to the effectiveness of the respondent bank's compliance system and its ability to conduct customer due diligence in line with international or its home AML/CFT standards. To the extent a respondent bank is a small indigenous bank with a business model involving high-risk activities such as online gaming, the correspondent bank would unlikely have confidence in the ability of such a bank to manage risks and may choose to terminate the CBR. In addition, where the respondent bank has an opaque ownership and control structure, it may be more challenging for the correspondent bank to ascertain the beneficial owners of the respondent bank and mitigate the risks accordingly. Pressure from correspondent banks to comply with AML/CFT requirements may thus also be leading respondent banks to terminate relationships with some categories of customers.

**35. The ability of correspondent banks to manage CBR risks depends on the quality of information recorded and timeliness of information provided by their respondent banks.** Low quality of information and poor responsiveness to requests for further information required of respondent banks inhibits the correspondent bank's ability to assess and manage the risk related to that particular relationship. This may reflect low capacity, resources or controls within the respondent bank, weak AML/CFT requirements or poor quality of supervision in the relevant country, and/or a lack of transparency of the legal entities and arrangements that are customers of

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<sup>9</sup> *FATF Recommendation 13 on Correspondent Banking* requires financial institutions, in relation to cross-border correspondent banking and other similar relationships, in addition to performing normal customer due diligence measures, to: (a) gather sufficient information about a respondent institution to understand fully the nature of the respondent's business and to determine from publicly available information the reputation of the institution and the quality of supervision, including whether it has been subject to a money laundering or terrorist financing investigation or regulatory action; (b) assess the respondent institution's AML/CFT controls; (c) obtain approval from senior management before establishing new correspondent relationships; (d) clearly understand the respective responsibilities of each institution; and (e) with respect to "payable-through accounts", be satisfied that the respondent bank has conducted customer due diligence on the customers having direct access to accounts of the correspondent bank, and that it is able to provide relevant customer due diligence information upon request to the correspondent bank. In addition, financial institutions should be prohibited from entering into, or continuing, a correspondent banking relationship with shell banks. Financial institutions should be required to satisfy themselves that respondent institutions do not permit their accounts to be used by shell banks. <http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html>.

<sup>10</sup> Categories of customers include MTOs, exchangers, NPOs, casinos, offshore financial institutions and corporations, and politically exposed persons.

the respondent bank. Therefore, where the beneficial ownership information is not available, a global bank may not have sufficient information to satisfy itself that economic and trade sanctions, particularly under the OFAC, are not being violated and therefore may not be comfortable entering into or continuing with a particular CBR.

**36. Conflicting regulatory or legal requirements, notably between customer due diligence and data protection and privacy, also hinder global banks' ability to manage CBR risks by restricting the exchange of customer information.** Data protection and privacy requirements can significantly hinder information sharing between banks, especially across borders, and prevent a correspondent bank from conducting effective customer due diligence on its respondent counterpart. In situations where the correspondent bank has insufficient information on the risk profile of the respondent bank, or if hindrance to information sharing unduly raises its customer due diligence costs, it may decide to terminate the CBR. Data protection and privacy requirements can also hinder information sharing within global banking groups preventing a branch or subsidiary from communicating a suspicious transaction report to the rest of the financial group, affecting the group's ability to effectively manage risk. In some instances, the impediments in this regard are of a constitutional nature. That said, according to Principle 12 of the Basel Core Principles for Effective Banking Supervision, a banking group should not be allowed to open a branch or subsidiary if material information cannot be accessed (Basel Committee on Banking Supervision, 2012).

## POLICY RESPONSES AND INDUSTRY INITIATIVES

**37. Addressing the withdrawal of CBRs requires coordinated and collective action by public and private stakeholders.** Several initiatives are currently being considered, and in some cases already being implemented. In addition to efforts to better understand this phenomenon, these include initiatives to address the specific drivers and mitigate the potential impact of CBR withdrawal. Efforts have been made by the Fund, the World Bank, and the FSB,<sup>11</sup> including through facilitation of international dialogue to develop coordinated policy responses and support industry initiatives. Recognizing that the economic impact of CBR withdrawal has been limited to date, the focus of most of these initiatives has been on preventing CBR withdrawal from reaching a critical level. These measures have varying timeframes and impact, present different implementation challenges, and have a number of potential drawbacks. Due consideration can also be given to commonalities of drivers and the trends of CBR withdrawal in certain regions, which may call for shared regional responses (Box 4).

<sup>11</sup> The FSB established in March 2016 a Correspondent Banking Coordination Group to implement the action plan presented to the G20 in November 2015 to assess and address the decline in CBRs. The action plan consists of four elements: (i) further examination of the dimensions and implications of the CBR decline facilitated by improved data collection by multilateral institutions and national authorities; (ii) clarification of regulatory expectations, as a matter of priority, including more guidance by the FATF; (iii) domestic capacity building in countries that are home to affected respondent banks; and (iv) strengthening tools for due diligence by correspondent banks.

#### Box 4. Regional Efforts in Addressing the Withdrawal of CBRs

##### Actions Undertaken by Caribbean Regional Bodies

**Caribbean regional bodies have stepped up efforts to raise awareness on the impact of the withdrawal of CBRs in the region.** The Caribbean has been one of the regions most severely affected by the withdrawal of CBRs. During the 27th Inter-Sessional meeting of the Conference of the Heads of Government of the Caribbean Community (CARICOM) held on February 16–17, 2016 in Belize, heads of government appointed a high-level advocacy group, led by the Prime Minister of Antigua and Barbuda to represent the interests of the region in addressing this issue. The Caribbean Development Bank (CDB) and the Jamaica National Building Society (JNBS) have offered to work alongside CARICOM on advocacy efforts and finding regional solutions. The Caribbean Association of Banks conducted a survey to better understand how banks in the region have been affected by the withdrawal of CBRs and is undertaking outreach to correspondent banks and other stakeholders to raise awareness of these issues.

**While efforts are being made at the national level, the Caribbean is looking to develop regional responses to address the drivers of the withdrawal of CBRs.** At the national level, progress is being made to improve the supervisory and regulatory frameworks, including on AML/CFT and in facilitating the international exchange of information. Recognizing that the drivers of the withdrawal of CBRs are very similar, particularly on issues related to economies of scale, countries are exploring regional approaches. For instance, in order to strengthen AML/CFT frameworks, members of the Eastern Caribbean Central Bank (ECCB) have decided to consolidate their national AML/CFT supervision into one regional operation, under the responsibility of the ECCB.

##### Actions Taken by the Gulf Cooperation Council

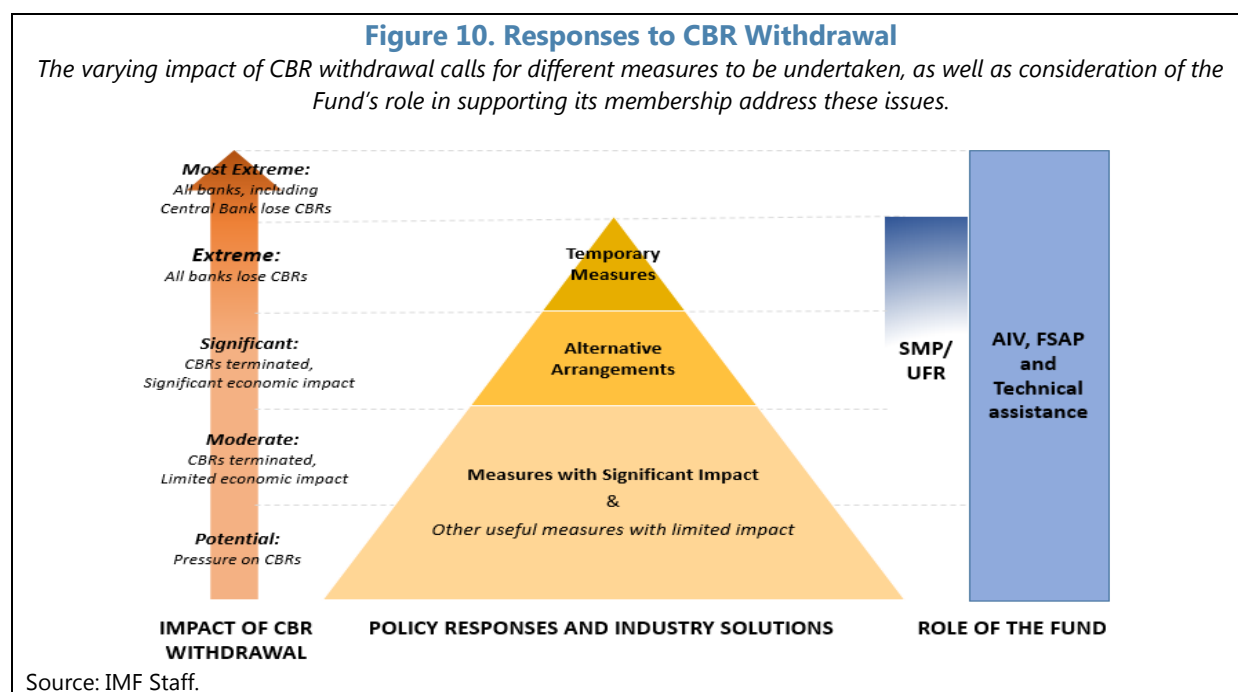
**The Gulf Cooperation Countries (Bahrain, Kuwait, Oman, Qatar, the Kingdom of Saudi Arabia, and the United Arab Emirates), and the U.S. government have been closely engaging with each other at a high level on issues related to CBRs.** The U.S. Department of the Treasury held a public-private dialogue to discuss trends in illicit finance, correspondent banking, and de-risking at the Federal Reserve Bank of New York in November 2015. Participants included representatives from countries and organizations and the private sector. Discussions covered issues related to financial inclusion and public and private sector perspectives on money laundering and terrorism financing facing countries and institutions. This engagement enabled Gulf Cooperation Council authorities, international regulators and private sector representatives to hear directly from their counterparts about: (i) government expectations of industry; (ii) private sector implementation of those expectations, including policies, practices, and procedures; and (iii) private sector expectations of foreign counterparts as they manage CBRs. A second meeting of the forum held in June 2016 advanced the conversations started in November 2015 and largely focused on issues related to implementation of AML/CFT standards and maintenance of the cross-border CBRs.

Source: IMF staff.

**38. Countries concerned with CBR withdrawal should continue gathering data and monitoring pressure on CBRs to inform their approach to addressing this issue, and consider developing contingency measures if needed.** Data gathering efforts and surveys would contribute to a better understanding of the nature, scale, and scope of the withdrawal of CBRs, and enable authorities to prioritize actions and tailor responses to country-specific circumstances. Efforts have been made at the national and regional levels to better understand and raise awareness of specific

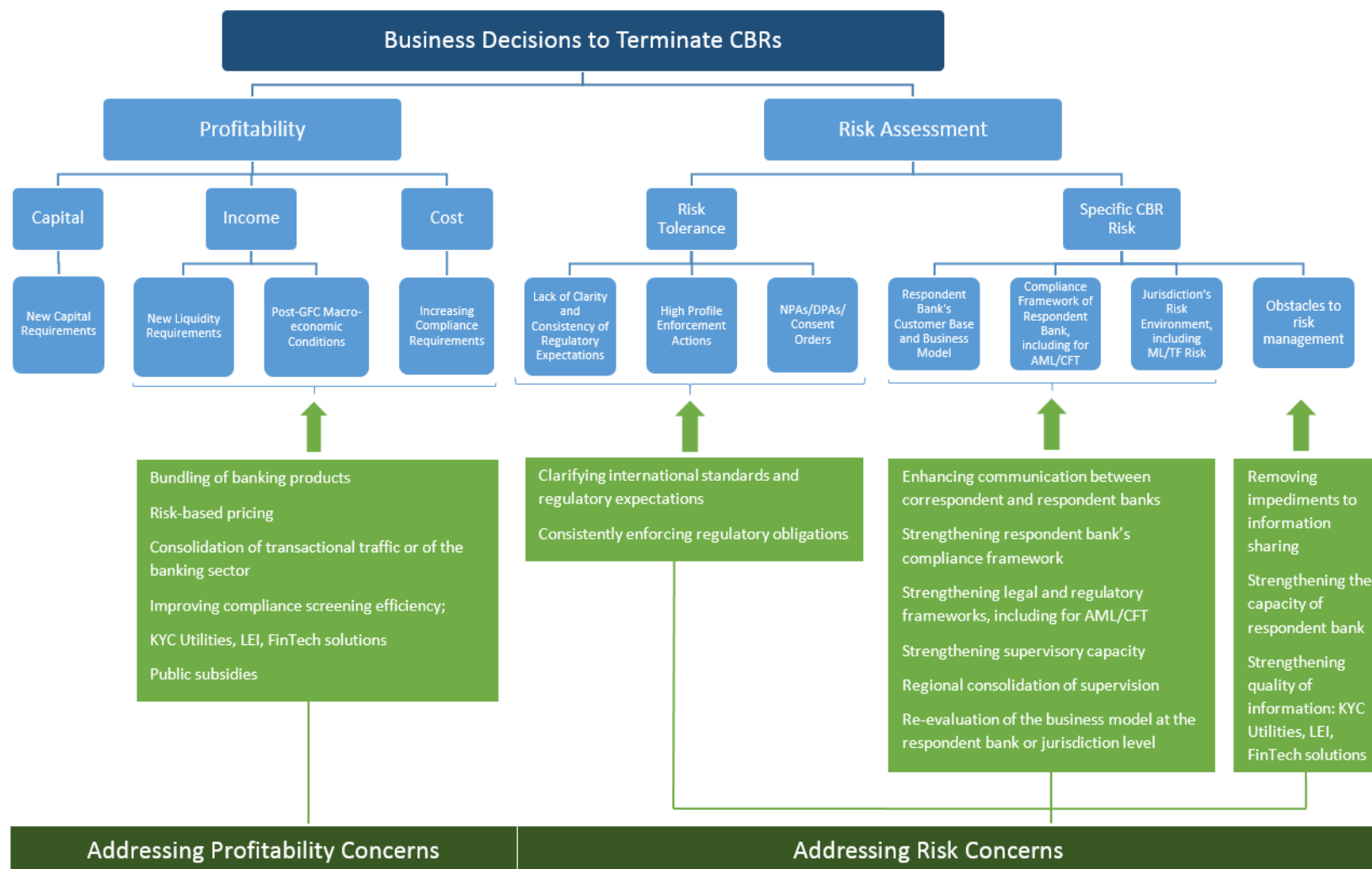
ways in which the phenomenon affects a country or a region.<sup>12</sup> Improvements in statistical analysis of CBR information by source and affected countries, including the use of actual CBR payment data (e.g., SWIFT), would also assist in better understanding and monitoring of the phenomenon. Depending on the likelihood that CBR withdrawal will reach a critical level, the authorities should develop contingency measures to mitigate the risk of a major disruption to cross-border financial flows. These plans could include enhancing communication among all stakeholders, developing a thorough understanding of domestic financial systems' linkages with correspondent banks and alternative payment arrangements (CPMI 2014), and enhancing institutional capacity.

**39. Responses to CBR withdrawal need to be tailored, prioritized, and sequenced depending on the intensity of the impact (Figure 10).** Given the multitude of drivers, there is no one-size-fits-all solution to CBR withdrawal, and the priority of measures would depend on their impact and effectiveness in addressing this phenomenon (Figure 11). In countries where the withdrawal of CBRs is significant, alternative arrangements and market innovations could be considered to help contain and mitigate the impact of CBR withdrawal, though these will not necessarily address the underlying drivers. In the event of a complete loss of CBRs by all banks in a country, it may be necessary to consider temporary measures, including the possible involvement of public entities over a limited time period. In most of these cases, the Fund has a role to play through its bilateral surveillance and capacity development programs and by facilitating dialogue among all parties, with engagement through Fund-supported programs where relevant (Section V).



<sup>12</sup> In Mexico, authorities are drafting regulations to enhance data collection by designating certain message types and message fields in payment system messages as mandatory for completion by banks. In The Bahamas, authorities have undertaken correspondent banking surveys of the banking sector. By April 2017, the FSB will publish the results of a survey based on anonymized bank-level data and aggregate country-level data from 300 banks in more than 50 countries and look into aggregated transaction amounts by country and currency using actual payment data from SWIFT where possible.

**Figure 11. Mapping Policy Responses and Industry Initiatives to Drivers of CBR Withdrawal**



Source: IMF Staff.

## A. Measures with Significant Impact to Address CBR Pressures

**40. As decisions to terminate CBRs are mainly driven by correspondent banks' concerns about their ability to cost-effectively manage risks, boosting their confidence in respondent banks' risk management capacity and the regulatory environment becomes paramount.**

As explained in Section III, the ability of a correspondent bank to manage CBR risks depends on its confidence in a respondent bank's internal monitoring system and the general regulatory and supervisory framework. Immediate responses should focus on those targeted measures to enhance respondent banks' capacity to manage risks, to increase correspondent banks' appetite to manage risks associated with CBRs, and to strengthen the regulatory framework and its effective implementation. These efforts should be accompanied by more consistent communication and implementation of regulatory expectations, removal of impediment to information sharing and ongoing data gathering and monitoring pressures on CBRs to tailor the required measures.

**41. Greater communication between correspondent and respondent banks on risk management is a prerequisite.** Frequent dialogue between banks is necessary to build a common understanding of risks, clarify the concerns that correspondent banks may have, and build familiarity and confidence in the CBRs. Correspondent banks should clearly communicate their risk tolerance policies and expectations, including by issuing policy statements on transactions that are prohibited and which they consider "high risk." In turn, respondent banks should explain their risk management frameworks and practices, as well as their efforts to enhance capacity and strengthen their risk management and compliance programs.

**42. Public and private stakeholders should join forces in strengthening the capacity of respondent banks to manage risks.** Correspondent banks can intensify their efforts to provide targeted technical assistance (TA) and training to strengthen respondent banks' capacity. In this regard, sharing of best practices between correspondent and respondent banks, and between respondent banks themselves, could help respondent banks identify gaps and weaknesses in their risk management and compliance programs, and take informed remedial actions to improve their programs. Regional development banks (RDBs) can play an important role in providing training to enhance the ability of respondent banks to effectively manage risks, and the Fund can support this effort by providing training to these RDBs.

**43. The automation of due diligence processes could also help improve the quality and timeliness of information available to correspondent banks to assess and manage risks.** Some small respondent banks still manually process the information they collect when onboarding new customers and when monitoring the business relationships against potential money laundering or terrorism financing risks. This is unlikely to reassure a correspondent bank on the ability of these respondent banks to manage risk and to respond timely to its requests. Digitalizing account documentation (e.g., identification information, business correspondence, account activity, and checks) would help enhance compliance screening procedures in banks. It would also help reduce cost of implementing the customer due diligence measures expected by correspondent banks in the long run. While the respondent bank is ultimately responsible for conducting customer due



diligence, initiatives at the national or regional level could assist the process (e.g., pooling with other banks to develop IT solutions or to access commercial database identifying high-risk customers). However, this would take time to implement and would be subject to resource availability.

**44. If capacity cannot be achieved at the individual respondent bank level, consolidating transactional traffic, and terminating certain high-risk business lines may be needed to address correspondent banks' concerns about risk management.** Consolidation of transaction traffic could be achieved through “downstreaming,” in which the transactions of several respondent banks are transparently channeled through an intermediary bank with robust controls in place, and consolidating small-sized respondent banks to ensure sufficient level of transactions flows with correspondent banks and economies of scale to support the investments and capacity needed for sound due diligence processes. “Downstreaming,” which is intended to ensure full transparency throughout the relationship chain in contrast to nested relationships, is already gaining traction in the Caribbean region. Consolidation of small-sized banks would help to the extent that the affected country or region is overbanked. Finally, to the extent a respondent bank lacks the capacity to manage risks associated with certain high-risk businesses (such as online gaming and offshore), it may need to terminate such business applying a risk-based approach, so as to maintain its CBRs.

**45. Improving regulation and supervision, particularly for AML/CFT, and ensuring their effective implementation is crucial to provide the level of confidence required by correspondent banks.** The general regulatory environment, which is viewed as proxy for respondent banks' risk management programs, needs to give correspondent banks confidence that the regulatory and supervisory framework allows for implementation of the AML/CFT policies required by their home regulators. Irrespective of the nature and scale of CBR withdrawal, efforts should be made to strengthen regulatory and supervisory frameworks and their effective implementation, in line with international standards, including AML/CFT standards and the Basel Core Principles for Effective Banking Supervision (Box 5). In this regard, targeted AML/CFT diagnostic studies could help assess the main gaps and weaknesses in these frameworks and identify ways to address them. In order to achieve effective regulation, political buy-in at the highest levels of government is required to adopt necessary reforms, along with sufficient supervisory capacity and resources.

**46. Harmonization of AML/CFT legislation and consolidation of supervision on a regional level could be beneficial for groups of smaller countries.** Consolidation of supervision can help to achieve the scale necessary to implement the needed reforms and ensure that all financial institutions in the region adhere to the same standards, providing a level playing field for correspondent banks. For instance, the ECCB is consolidating all AML/CFT supervision into one regional operation under its responsibility. However, this solution would require strengthening governance arrangements and capacity of regional supervisors to ensure effective implementation of regulations.



### Box 5. Efforts by the Financial Action Task Force and Basel Committee on Banking Supervision to Clarify International Standards

*Calls for greater clarity in international standards are being addressed by the FATF and the Basel Committee on Banking Supervision (BCBS) to help ensure consistency of regulatory expectations, including for AML/CFT standards.*

**The FATF:** The FATF has responded to calls for greater clarity in international standards for AML/CFT, including to issue guidance on CBRs. In response to indications from some global banks that a lack of clarity of the scope of customer due diligence requirements has made them more reluctant to enter into or maintain certain types of CBRs, the FATF has taken steps to clarify the international standards on AML/CFT and published a guidance on CBRs in October 2016. In particular, the guidance (i) clarified that the FATF recommendations do not require financial institutions to conduct customer due diligence on the customers of their customers; (ii) highlighted that not all CBRs carry the same level of money laundering and terrorism financing risks, hence any enhanced due diligence measures have to be commensurate to the degree of risks identified; (iii) identified ways to verify respondent bank's information and to document higher risks; (iv) noted that correspondent banks should conduct ongoing monitoring and maintain ongoing communication and dialogue with respondent banks; and (v) defined requirements associated with establishing nested relationships.

**The BCBS:** The BCBS is in the process of revising the correspondent banking annex of the guidelines on the sound management of risks related to money laundering and terrorism financing. A consultative document issued in November 2016 discusses issues that financial institutions should consider when using "know your customer" (KYC) utilities, and the role supervisors can play concerning the quality of payment messages.

Source: FATF, 2016; BCBS, 2016.

**47. Building on intensified initiatives by home supervisors to clarify regulatory expectations, further efforts to ensure consistent implementation and communication of these expectations would help alleviate global banks' concerns.** For instance, U.S. regulators published in August 2016 a Joint Fact Sheet on Foreign Correspondent Banking which outlines their supervisory and enforcement processes with respect to AML and sanctions in relation to correspondent banking (U.S. Treasury, et.al., 2016). In October 2016, the U.S. Office of the Comptroller of Currency (OCC) issued Risk Management Guidance on Periodic Risk Reevaluation of Foreign Correspondent Banking to describe corporate governance best practices for banks' consideration when conducting periodic evaluations of risk and making account retention or termination decisions relating to foreign correspondent accounts (OCC, 2016).<sup>13 14</sup> The U.K. Financial Conduct Authority (FCA) also issued Financial Crime Guide to help firms to adopt a more effective, risk-based and outcomes-focused approach to mitigating financial crime risks (FCA, 2015). Moreover, the FCA now considers whether the strategies related to the withdrawal of CBRs affects consumer protection or competition issues (FCA, 2016). However, according to feedback from some

<sup>13</sup> This includes providing minimum written notice periods to respondent banks to avoid acute disruption. U.S. regulators have made clear that they do not follow a "zero-tolerance" approach and that financial institutions are required to adopt a risk-based approach to due diligence procedures. They clarified that they follow a process of escalation from supervisory involvement to enforcement action and eventually prosecution and sanction.

<sup>14</sup> In the U.S. Article IV, U.S. authorities noted that regulators' principle focus was to ensure that internal controls were appropriate and proportional to the risks of the institutions' operations. The supervisors' preference was for these activities to remain within the regulated financial system and within institutions having appropriate risk-based controls in place.

global banks, despite these efforts, it remains critical for home regulators to continue to clearly communicate that they do not follow a “zero-tolerance” approach, and to ensure consistent implementation of regulatory expectations by all relevant regulators within a country.

**48. Removing existing impediments to information sharing could also help improve correspondent banks’ ability to manage their risks.** The private sector has identified such impediments as a key issue in some countries, as privacy laws may prevent the transmission of additional information by the respondent bank to its correspondent bank concerning transactions, their originators, and beneficiaries. In this regard, ways to tackle obstacles to information sharing should be further explored, including amendments to legal frameworks, if required. For example, the Mexican authorities have adopted regulations to remove previously existing legal barriers to information sharing arising from Mexico’s banking secrecy laws and to permit domestic banks to share specific additional information on certain cross-border transactions with registered foreign correspondent banks. In some instances, where there are no legal barriers, respondent banks can re-draft banking contracts with customers or/add a supplementary agreement to allow the sharing of information (CPMI, 2016).

## **B. Measures with a Limited Impact to Address CBR Withdrawal**

**49. Additional measures being considered or implemented could help alleviate pressure on CBRs, but are unlikely to solve the problem.** These include initiatives targeted at addressing correspondent banks’ profitability concerns by increasing economies of scale, such as bundling banking products, and considering risk-based pricing of correspondent banking services. They also cover initiatives designed to lower compliance cost either by facilitating compliance screening procedures or by considering publicly financed programs. The feasibility of some of these measures has yet to be established, and most of these will take time to be implemented and are unlikely to yield immediate results.

**50. Market-based solutions, such as bundling of banking products, and volume or risk-based pricing, may help generate more income for correspondent banks.** Some correspondent banks are bundling other banking services (e.g., credit card clearing, letters of credit, and fixed-income and wealth management operations) with CBRs and are looking at the profitability of the relationship holistically, but such measure seems to have limited impact on maintaining CBRs. There may be scope for risk-pricing correspondent services to factor compliance costs into their fee structure and make the risk-return profile more efficient. The respondent bank could then pass on these higher costs to its customers. However, the increased cost may have implications for financial development and inclusion. In particular, a search for low cost alternatives may have the unintended consequence of pushing payments into informal channels.

**51. Improving compliance screening procedures, including through “Know Your Customer” (KYC) utilities, digital identity, improved payment messages, and the use of the Legal Entity Identifier (LEI) can help lower overall compliance costs.** KYC utilities and centralized information repositories can facilitate information sharing, which can also help reduce the cost of compliance. Initiatives in this area vary depending on feasibility. KYC utilities are being developed

for respondent banks to store and update their own information to facilitate access to relevant customer due diligence information by correspondent banks (e.g., SWIFT KYC Registry). Some global banks are establishing KYC utilities within financial conglomerates to facilitate group-wide risk management of their customers. In addition, some countries are in the process of creating a national KYC utility using trusted government collected personal data (e.g., Singapore). The development of digital identity could also facilitate the sharing of customer's information (e.g., Estonia's e-residency). Efforts also can be made to improve the quality of payment messages (e.g., Mexican authorities have designated certain message types and messages fields in payment system messages as mandatory for completion by banks). Efforts are also being made to promote the use of the LEI,<sup>15</sup> which can be used to identify banks involved in correspondent banking and banks' corporate customers. However, these initiatives will take time to implement: the more ambitious the initiative (e.g., global KYC utilities; global LEI), the longer the time needed for implementation. More importantly, banks cannot rely solely on these initiatives to meet the due diligence requirements.

**52. Reduction of compliance costs could also be achieved by publicly financed programs to safeguard access to finance for certain categories of customers.** Respondent banks may terminate business relationships with certain categories of customers, including MTOs, NPOs, and small- and medium-term enterprises, where the increase in compliance costs exceeds the income to be made through these business relationships. To address issues related to financial inclusion and social development goals, the public sector could consider providing some form of financing for compliance costs associated with these customers; for example, the government could provide financing support to CBR maintenance costs, or a domestic AML/CFT utility (and, in this way, covering a part of the compliance costs) from the point of view that access to the international payment system is a public good. However, this may create market distortions and face budgetary constraints. In addition, it may be difficult to define the scope of categories at risk of being financially excluded.

## C. Alternative Arrangements to Mitigate the Impact of CBR Withdrawal

**53. To mitigate the impact of CBR withdrawal, respondent banks have tried to substitute the loss of direct CBRs using alternative arrangements, although these options do not necessarily address the underlying drivers.** Such options include: (i) finding replacements through second- and third-tier correspondent banks; (ii) increasing the use of nested CBRs, (iii) switching to CBRs in other foreign currencies where feasible; and (iv) relying on other types of cross-border financial services such as letters of credit and trade finance. However, there are limitations to these alternatives. A sudden increase in payments through nested CBRs may lead to enhanced scrutiny of the nested relationship and increase costs. Switching to CBRs in foreign currencies may not be feasible for trade in global goods and services, which are traditionally denominated in a specific

<sup>15</sup> The LEI is a 20-character alpha-numeric code used to uniquely identify legally distinct entities that engage in financial transaction and which can help financial institutions identify specific entities unambiguously and increase the effectiveness of automatic screening packages, particularly for identifying sanctioned entities.

currency. In addition, while enhanced documentation required for establishing trade finance and letters of credit can provide additional scrutiny of clients, these services tend to be more expensive.

**54. Some new players seem to be filling the gap by offering correspondent banking services.** Some smaller U.S. banks, and other banks and specialized institutions have taken up the role played before by global correspondent banks by offering correspondent banking or by offering nested correspondent accounts. However, global correspondent banks need to feel confident enough to rely on the compliance screening of these institutions offering CBRs and providing nested accounts.

**55. Another option which has been discussed is the creation of a regional U.S. banking institution to provide regional banking services.** This option, which has been considered by the Caribbean, would involve establishing a regional presence in the U.S. to create a strong and sustainable pipeline of correspondent banking traffic. It would be a complex and costly process, taking significant time to establish and requiring extensive licensing and regulatory approval from U.S. regulators. In addition, this newly created bank would be subject to the same regulatory requirements as global banks and the risk of occurrence of enforcement penalty for breaching U.S. regulations would not diminish.

**56. Alternative remittance channels, including postal payment services can be used for cross-border payments.** These include existing remittance channels such as MTOs, postal networks, credit unions, telecommunication companies, courier companies, and trade-based remittance systems (IMF, 2009). With respect to postal payment services, a majority of post offices in various countries provide payment services in the form of money orders, which could facilitate international remittances. The Worldwide Electronic Postal Payment Services Network provides the underlying infrastructure to facilitate the movement of money orders across borders, and the Universal Postal Union establishes for member countries the common principles applying to postal payment services. Post offices either provide their own services for international money transfers or act as agents for other money transfer companies. However, while the postal network covers almost all areas of the world, it has not been fully used in cross-border transfers of remittances due to limits on transactions, liquidity problems in the disbursing outlets in the receiving countries, and delays.

**57. Emerging Fintech solutions could facilitate cross-border flows and potentially provide an alternative to traditional correspondent banking in the longer term.** Fintech and new payment initiatives may provide alternatives for cross-border payments compared to CBRs or traditional MTOs, notably through the use of virtual currencies and distributed ledger technology or “blockchain.” These alternatives promise much faster—potentially instantaneous—cross-border flows, at a fraction of the current cost. Fintech also has potential applications that could enhance the existing cross-border payment infrastructure. If successful, the market structure would change substantially overtime, as these new technologies could alter the increasing return to scale now observed in payments services and create room for market-based transactions outside the larger banks. One example would be the mobile phone operated cross-border payments currently being experimented within East Africa. However, at this stage, some Fintech startups may be operationally limited in the volume of transactions they are able to handle depending on their business model. So

far, the Fintech solutions still interface at some point with the banking system, where similar AML/CFT concerns may appear as in regular banking transactions. These concerns will need to be dealt with in addition to the new regulatory and supervisory challenges raised by these emerging technologies. To address these challenges, effective oversight frameworks for new payment methods need to be developed to safeguard public confidence and financial stability (Box 6). In particular, authorities should establish: (i) a clear legal regime; (ii) proportionate AML/CFT measures to prevent financial integrity risks; (iii) fund safeguarding measures such as insurance, similar guarantee schemes, or “pass-through” deposit insurance; (iv) contingency plans for operational disruptions; and (v) risk controls and access criteria in payment systems (Khiaonarong, 2014).

#### Box 6. Possible Role of Blockchain within Correspondent Banking

**Blockchain or distributed ledger technologies may offer a potential solution to the withdrawal of CBRs and facilitate many other types of payments in the future.** A blockchain is a type of distributed ledger, comprised of unchangeable, digitally recorded data in packages called blocks, stored in a linear chain. By design, blockchains are inherently resistant to modification of the data—once recorded, the data in a block cannot be altered retroactively. Providers have suggested that blockchain could alleviate some correspondent banking issues by enabling better risk management, reducing costs, and providing an alternative payment platform, especially regarding the transfer of small value payments.

Several challenges need to be addressed before these technologies achieve widespread adoption:

**It is still early days for Fintech regulation and supervision.** Emerging technologies need to be brought into the regulatory framework to avoid systemic risk, risk of money laundering, terrorist financing, and other illegal activity, and protect users. Industry and regulators also need to better understand how these technologies might affect firms’ ability to comply with evolving prudential, AML/CFT, reporting, and audit requirements. Some of these emerging technologies, commonly referred to as “Regtech,” also hold potential to enhance compliance with existing regulatory obligations.

**Solution providers must be able to handle larger flows of transactions.** While only a starting point, the current number of transactions per second for existing crypto-currencies are several orders of magnitude below centralized networks’ rates.

**The ability of companies to detect and be resilient to cyber-attacks is crucial for adopting these technologies and overcoming security concerns associated with correspondent banking.** While these nascent technologies promise higher security, not every aspect of these innovations is immune to increasingly sophisticated cyber-attacks. Blockchain code has already been exploited in the Decentralized Autonomous Organization hack, and users of the technologies are not immune to phishing and social engineering attacks. Additionally, distributed ledger technologies might be subject to collective action problems, game theory-based attacks, and attacks unique to distributed ledger and blockchain technologies. Wider cyber-security concerns would thus still need to be addressed before use for correspondent banks.

**The lower cost advantages might not be maintained.** The cost advantages of the “proof-of-work” system might not be sustainable, and the suggested “proof-of-stake” has not had a long enough track record to be recognized as a viable solution.

Source: He, et. al. (2016).

## D. Temporary Measures in the Event of Abrupt and Comprehensive Loss of CBRs

**58. In the event of a complete loss of CBRs by banks, consideration may be given to the use of public entities or centralized payments systems.** This would likely occur as a result of a sudden event, due to internal or external factors, rather than a gradual process of refocusing banks' business models. The experiences of some countries in establishing mechanisms involving public sector entities to facilitate payments may offer useful insights for developing effective responses to extreme circumstances, such as civil unrest, that may threaten the domestic banking system's CBRs. Possible regional initiatives could include the setting up of regional payments arrangements. Some central banks located in countries affected by the CBR withdrawal have also considered the feasibility of a temporary mechanism with foreign central banks in globally systemic countries to settle low risk transactions. This is however contingent on the interest of foreign central banks in participating in such arrangement. Another measure which has been discussed is the possible use of central bank CBRs to process payments on behalf of commercial banks' clients. There are also potential public solutions to mitigate the macroeconomic impact of CBR withdrawal on the flow of remittances that could be considered (Box 7).

**59. The design of any public vehicles requires care in assessing legal and operational feasibility and in mitigating potential risk exposures for central banks.** Potential legal constraints that would prevent central banks in some countries from acting as counterparty in commercial transactions would need to be addressed, while authorities would also need to ensure that such mechanisms were only used for transactions satisfying relevant regulatory standards and applicable AML/CFT obligations. Indeed, a public entity attempting to carry out bundled transactions would likely face the same challenges that respondent and correspondent banks face, and a central bank could risk its own CBRs if it attempted to carry out transactions that global banks have already categorized as high risk.<sup>16</sup> Furthermore, any proposed public intervention should be time-bound and limited, with exit strategies encouraging the reestablishment of commercial CBRs in the medium and long term.

**60. Public sector intervention would be needed where certain categories of customers are severely affected by the withdrawal of CBRs (such as NPOs and MTOs).** The termination of business relationships with such categories of customers may have a potentially adverse impact on highly vulnerable segments of the population. Accordingly, the public sector might consider intervening to facilitate payment transactions for specific categories of customers, for example by establishing a special ad-hoc temporary payment mechanism. Possible measures can build on experiences from New Zealand, the U.K., and the U.S. (Erbenova, et.al, 2016). For example, in 2013, when the accounts of Somali MTOs were being shut down by U.K. banks, the U.K. government

<sup>16</sup> In the case of the Mexican domestic payment system for USD transfers, enhanced AML/CFT obligations and sanctions are implemented on participating banks. Participants are required to have dedicated compliance officers, assess their compliance with AML/CFT regulations, report to the central bank on a semi-annual basis, and have a methodology to rate their clients according to AML/CFT risk (and revise the rating semi-annually). The authorities have also established KYC, screening and monitoring, payment messages and sanctions requirements.

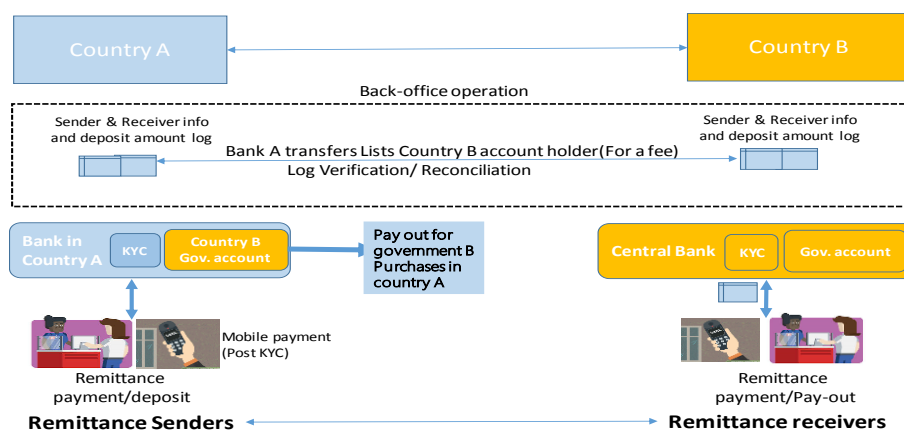


looked into the option of setting up a *Somali—U.K. Safer Corridor Pilot* to be mobilized in the event of a significant disruption in remittances. The objective of this initiative was to address bank's AML/CFT concerns and provide assurance to banks that risks can be managed, and to assist the Somali authorities to build a regulated financial sector. The need to mobilize this pilot did not materialize as remittances have continued to flow. It should be noted that given the temporary nature of such mechanisms, an exit strategy would also need to be developed to establish a more permanent response to the withdrawal of CBRs.<sup>17</sup>

### Box 7. A Potential Temporary Public Response to the Flow of Remittances

**Given the adverse macro financial impact that a disruption of the flow of remittances would imply for many countries, public sector may need to intervene and offer an interim public solution.** In the face of an imminent risk of losing all correspondent banks servicing this sector, a potential option would be to set up a temporary mechanism of contingency arrangements with the authorities of the country where remittances originate and with at least one of its banks.

**The temporary mechanism would entail the deposit of remittances into the recipient country's government bank account in the origination country.** This could be an agreed upon central bank, treasury, or embassy bank account. The bank would not transfer any of these remittances: deposited funds would be used by the recipient government for local payments in the country where remittances originate. At the same time, the recipient government would be responsible for paying out the remittances to the intended beneficiaries in the home country. For this mechanism to work, depositors would need to fully trust in the integrity of the recipient government and its capacity to efficiently distribute the funds.



**This set-up would need to be discussed with the bank in which the government account is held and the regulator to assure that the arrangement complies with the applicable AML/CFT standards.** The prior involvement of regulators would be needed to ensure that the framework is in line with AML/CFT requirements.

Source: IMF staff.

<sup>17</sup> Under the most extreme scenario, a country's entire financial system including its central bank might be cut off from CBRs, or at imminent risk of being cut off. Under these circumstances, where CBR loss is due to a system-wide non-compliance with AML/CFT standards, it likely would not be possible to establish adequate safeguards to establish the conditions for provision of Fund financial assistance. Priorities in such an extreme case would be to facilitate and support the discussion among relevant stakeholders on quickly establishing payment corridors for humanitarian aid and to maximize the impact of capacity development to strengthen the member's AML/CFT framework based on the most critical identified drivers and weaknesses.

## THE FUND'S ROLE IN ADDRESSING THE WITHDRAWAL OF CBRs

**61. Staff will continue to follow a multipronged approach to support member countries in addressing issues arising from the withdrawal of CBRs in coordination with the FSB, multilateral development banks and other stakeholders (Box 8).** The various elements of the approach will depend on the impact of the CBR withdrawal in each country. In general, the Fund will continue to facilitate international dialogue on regulatory expectations and enhance data gathering efforts across the membership. In countries where a concentration in cross-border flows is substantially accentuating financial fragilities, Fund surveillance and FSAPs will seek to identify drivers, monitor risks, and provide policy advice on responses. Capacity development programs will be tailored to address the issues related to CBR withdrawal. Finally, in the extreme case of a systemic loss in CBRs, the Fund will support efforts to put in place preconditions for payment flows and a framework for humanitarian assistance as needed, to the extent all CBRs of commercial banks have been lost. Each element of the multi-pronged approach is detailed below (Annex IV describes the approach staff are testing to develop responses in some countries and regions affected by CBR withdrawal).

**62. Staff remains committed to facilitate candid and constructive dialogue among all parties to achieve practical responses.** Through its membership in the FSB and its active participation in the FATF plenaries and BCBS groups, the Fund can support further clarification of international standards and how they apply to correspondent banking. Staff will engage regulators of correspondent banks to continue to communicate their regulatory expectations and to provide more guidance with respect to banks' voluntary remedial actions. Staff will continue to encourage member countries to work closely with correspondent banks to promote greater transparency on their decisions to terminate CBRs, including by providing sufficient time for respondent banks to find suitable alternatives, notably for remittances. Fund staff will also continue to keep abreast of industry initiatives that hold promise in addressing some of the drivers behind the withdrawal of CBRs and that could provide alternative channels to correspondent banking for safe and reliable payments. As discussed above, industry initiatives are underway, some being designed and others being implemented; staff will monitor their feasibility, cost, impact, integrity, and supervisory issues. In addition, where commercial banks in a member country may be at risk of losing all CBR relationships, the Fund can use its convening power to bring together relevant stakeholders in developing emergency measures where necessary, including in the development of special payment corridors.



### Box 8. How Has the Fund Responded to Member Countries' Concerns about CBR Withdrawal?

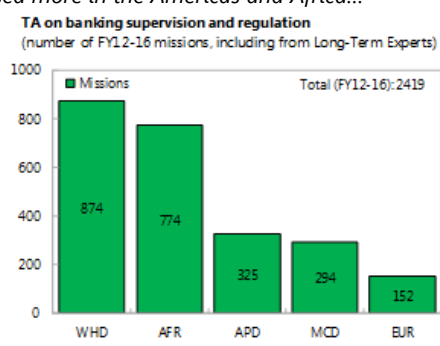
**The Fund has facilitated an international dialogue to foster a common understanding of the drivers of CBR withdrawal and to develop targeted policy responses.** To further advance these objectives, the Fund published a Staff Discussion Note on the issue in June 2016, highlighted by the Managing Director in a speech delivered at the New York Federal Bank, and hosted a high-level conference at the margins of the 2016 Annual Meetings.

**In the context of surveillance, the Fund has been assessing the macroeconomic and financial stability impact of CBR withdrawal, and providing advice, as needed.** A note to staff was issued to help country teams discuss these issues in Article IV consultations and guide data gathering to better assess the impact on Fund members. The withdrawal of CBRs has been discussed in the context of bilateral surveillance when deemed macro-critical for a country, or where agreed with the authorities. As the withdrawal of CBRs is not, at this time, considered to affect the effective operation of the international monetary system, it has not been considered in the Fund's multilateral surveillance.

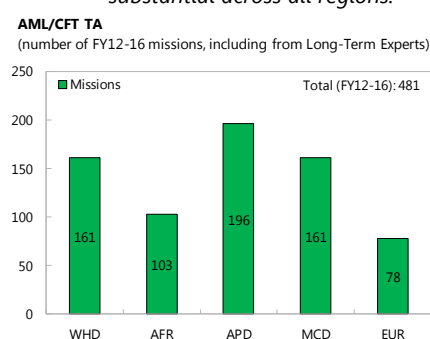
**The Fund has also been working extensively with its member countries to assess the effectiveness of their supervisory and regulatory frameworks.** The FSAP, established in 1999, has been instrumental in understanding these assessments both for the Basel Core Principles for Effective Banking Supervision and the FATF standards on AML/CFT. In conducting FSAPs, the Fund, jointly with the World Bank (except in the case of advanced economies), aims to help countries better identify weaknesses in their financial systems and potential sources of systemic risks. Between 2012 and mid-2016, 87 FSAPs were completed across all regions among the Fund membership. Many of these FSAPs identified shortcomings in the areas of banking supervision and AML/CFT, and called for strengthening frameworks.

**The Fund capacity development program is also helping countries strengthen legal, regulatory and supervisory frameworks.** Over the past four years, the Fund has provided technical assistance (TA) and training to approximately 170 countries to help them strengthen their supervisory and regulatory frameworks, including AML/CFT frameworks. The Fund currently has 146 ongoing projects in 121 countries (including TA provided through Regional Technical Assistance Centers). The Fund also contributes to the AML/CFT evaluation efforts of the FATF and its regional bodies for assessing and promoting members' compliance with the FATF recommendations. Full engagement by national authorities in combatting money laundering and terrorism financing, at the highest level is a precondition for a successful engagement, which could ultimately help limit the loss of CBRs.

*TA to strengthen supervision and regulation has been focused more in the Americas and Africa...*



*...while TA to strengthen AML/CFT standards has been substantial across all regions.*



1/ Speech by the IMF Managing Director at the New York Fed

<https://www.imf.org/en/News/Articles/2016/07/15/13/45/SP071816-Relations-in-Banking-Making-It-Work-For-Everyone>

Source: IMF staff estimates. AFR=sub-Saharan Africa, APD = Asia and the Pacific, EUR = Europe, MCD = Middle East and Central Asia; WHD = Western Hemisphere.

**63. Continued data-gathering efforts remain necessary to enhance the understanding of this phenomenon.** Follow-up analytical work on identifying the drivers and impact has been agreed upon with the authorities of the MENA and Sub-Saharan Africa regions, to be carried out closely with the Arab Monetary Fund and the Association of African Central Banks, respectively. National authorities are encouraged to improve their own data collection including by accessing SWIFT payment data. Moreover, recent Fund TA work using the Angolan authorities' own SWIFT CBR payment flow data and network analysis could be extended to other countries to better understand the nature, scale and scope of CBR withdrawal.

**64. The Fund will continue monitoring risks posed by withdrawal of CBRs via its surveillance, where the impact from loss in CBRs is considered macro-critical.** Assessing macro-criticality could take into account the relevance of remittances, trade financing or other CBR channeled capital flows for macroeconomic and financial stability. Staff could consider the potential impact of loss in CBRs on access to financial services. Where relevant, the withdrawal of CBRs can also be discussed in the context of surveillance discussions with currency union institutions to provide a regional perspective. Surveillance will also enable the Fund to accumulate cross-country experience with the various policy options and provide advice on the basis of best practices (Box 9).

#### **Box 9. Operational Guidance on Inclusion of CBR Issues in Bilateral Surveillance**

**Whenever issues arising from the withdrawal on CBRs rise to the level of macro-criticality, they should be discussed during the Article IV consultation and covered in the related staff report.** In addition, staff may also discuss CBR-related issues as part of policy advice where the member country agrees to discuss these issues on a voluntary basis. In any case, however, the country team should assess macro-criticality of CBR-related issues.

**During the mission, the country team will discuss CBR-related issues with the authorities, as appropriate, with support from LEG/MCM.** When significant risks for domestic or balance of payments stability, or global stability are identified, or when there is scope for the coverage of CBR-related issues on a voluntary basis, LEG/MCM staff will make available to the Article IV team a tailored background note on CBR-related issues in line with the findings of this Board Paper and will be ready to provide headquarter-based support during their mission. This background note will include talking points, questions and other supporting material tailored to the member country's circumstances for the Article IV team to use in their interactions with the authorities on CBR-related issues. Should CBR-related issues be particularly complex or require specialized knowledge in a given consultation, LEG/MCM staff could potentially join the Article IV mission, subject to availability.

**Following the mission, the staff report would include a discussion of the member country's current access to CBRs, the pressure faced by these relationships and the actions being considered to mitigate the potential consequences.** These elements should be included in the policy discussion and in the staff appraisal. To the extent that CBR-related risks could materially alter the baseline, these should be captured in the risk assessment matrix as appropriate. Ultimately, staff will provide advice on measures that need to be taken to prevent the loss of access to CBRs or to mitigate the fallout of such an event.

Source: IMF Staff.

**65. The Fund's capacity development work could be tailored to specifically address issues related to CBR withdrawal within the current budgetary envelope.** It is expected that there will be an increase in demand for capacity development activities by countries affected by the withdrawal of CBRs. Recognizing the multiplicity and interrelated nature of the drivers of CBR withdrawal, staff plans to deliver TA and training targeting specific circumstances to maximize limited available resources and deepen impact. Such assistance could be offered for individual countries and on a regional basis.

- *At the country level, the CBR capacity development program could follow a sequenced and targeted approach.* As a first step, a diagnostic module would focus on identifying the scale and scope of the problem and the relevant drivers specific to the requesting country. This module would include a data gathering component and the development of a country-specific action plan. Based on the identified drivers and TA priority needs, consideration could be given to include other technical assistance modules focusing on strengthening regulatory and supervisory frameworks and enhancing data collection along the lines of the TA undertaken in Angola.
- *At the regional level, the Fund could deliver capacity development focusing on regional responses and initiatives.* CBRs withdrawal has been more acute in certain regions where some of the drivers are common across several countries (e.g., economies of scale have been attributed to CBR withdrawal from smaller Caribbean countries). To address these issues, the Fund could take a regional approach, including through convening of regional seminars and providing regional training, involving the authorities, financial institutions, correspondent banks and their regulators, and in collaboration with other public sector TA providers, including regional development banks, to develop regional responses. The recently launched Caribbean Initiative is a pilot to follow this approach, which could also apply to other regions affected by CBR withdrawal. The Fund can make use of its Regional Technical Assistance Centers and Training Centers to deliver regional training. A new training course, whether online or delivered at these centers, on issues related to CBRs withdrawal drawing on the Fund's experiences and work so far on CBR issues could be designed.

**66. While surveillance and capacity development is expected to be broadly sufficient to address CBR related risks across the membership, tail-risk scenarios could require deeper Fund engagement.** For example, a severe loss of CBRs stemming from a deeper-seated complex of policymaking challenges across a range of areas, could imply significant macroeconomic impacts and difficulties in financing the country's balance of payments. In this context, a Fund supported program may be considered to help restore external and domestic imbalances. This engagement would be expected to take place within the existing frameworks, including ensuring adequate safeguards in case of use of Fund resources. This may involve measures on CBR withdrawal if viewed (i) of critical importance for achieving the goals of the member's program or for monitoring the implementation of the program; and (ii) within the member's control. Such measures could be accompanied by advice and TA on AML/CFT to help restore CBRs or help prevent remaining CBR corridors from being cut off.

## ISSUES FOR DISCUSSION

**67. Directors may wish to discuss the following issues:**

- Do Directors support staff ongoing involvement on CBR issues when relevant in the context of surveillance and Fund-supported programs?
- Do Directors agree with staff analysis of the feasibility, impact, and challenges of policy responses and industry initiatives, and on the role of public sector in the event of complete loss of CBRs?
- Do Directors agree with a tailored, prioritized, and sequenced approach to addressing the withdrawal of CBRs, depending on the country specific context?
- Do Directors endorse staff's proposals for future engagement with authorities, including through capacity development both at national and regional levels?

## Annex I. Channeling Payments Through the SWIFT Network

**1. CBR arrangements involve the exchange of message between banks, including through the SWIFT network.** These messages could be associated with payments, trade finance, foreign exchange, or securities transactions. The most commonly used standard for cross-border payments is SWIFT. Based on the analysis of payment flows through SWIFT, use of bank-to-bank channels were 67 percent of total volume. “On-us” payments carried out through a bank’s own branches accounted for 13 percent. Payments settled via cross-border financial market infrastructures such as through pan-European high-value and retail payment systems were 20 percent of the total (SWIFT, 2011).

### Box 1. SWIFT: What’s in a Message?

**Standards Message Types (MT) have been developed to support the business transactions of SWIFT users.** To ensure that the multitude of practices and conventions of users are in harmony, financial messages transmitted via the SWIFT network must adhere to the message text standards. Standards enable financial institutions to move from manual to automated initiation and processing of financial transactions.

**SWIFT messages are grouped into ten major categories.** This includes the following: (i) customer payments and checks; (ii) financial institution transfers; (iii) treasury markets, covering foreign exchange, money markets, and derivatives; (iv) collections and cash letters; (v) securities markets; (vi) commodities and syndications; (vii) documentary credits and guarantees; (viii) travelers checks; (ix) cash management and customer status; and (x) common group messages. An MT is composed of three digits, which generally define its category, group, and type. Group describes the function of the message. Type describes the specific function. Examples of common message types are as follows:

- MT 103—Single customer transfer, which instructs a funds transfer;
- MT 202—General financial institution transfer, which request the movement of funds between financial institutions except if the transfer is related to an underlying customer credit transfer that was sent with the cover method, in which case the MT 202 COV must be used;
- MT 202 COV—General financial institution transfer, which requests the movement of funds between financial institutions, related to an underlying customer credit transfer that was sent with the cover method;
- MT 300—Foreign exchange confirmation on agreement to buy and sell two currencies; and
- MT 700—Issuance of a documentary credit, indicating the terms and conditions.

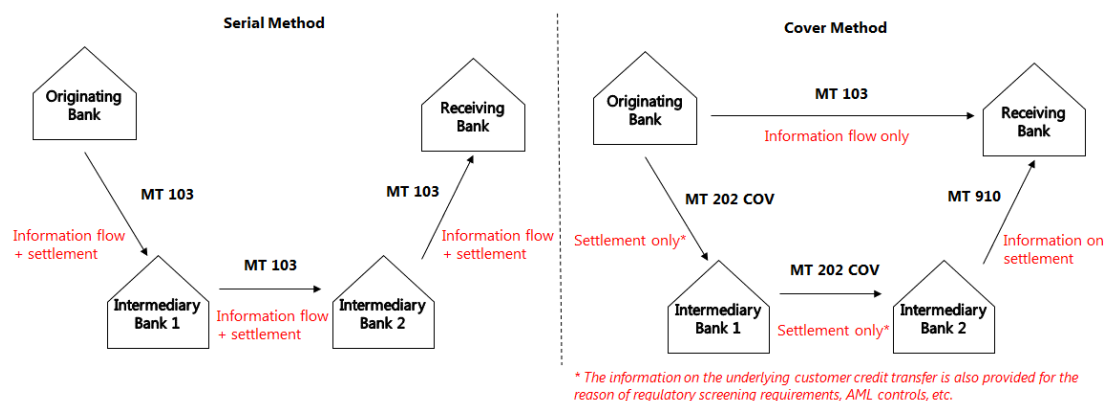
Source: SWIFT.

**2. There are two methods in channeling payments through the SWIFT network.** This includes the serial and cover methods (Box 1; CPMI, 2016). The serial method involves sending an MT 103 (or equivalent) from the originating bank to the receiving bank through one or more intermediaries. Each pair along the payment chain has a direct account relationship. The payment information and the settlement instruction travel together in the MT 103 message. The cover method decouples the settlement from the payment information. The MT 103 with the payment information is sent directly through the SWIFT network from the originating bank to the receiving bank, whereas the settlement instruction (the cover payment) is sent via intermediary banks through the path of direct CBRs. Both methods are used in practice when an originating bank has no bilateral

account relationship with the receiving bank, and can help fulfill compliance with AML/CFT and other relevant regulatory requirements provided that all relevant payment fields of the respective payment message are accurately completed.

### Box 2. Stylized Examples of the Serial and Cover Methods for a Correspondent Transaction

*The transparency of ordering customers and final beneficiaries underlying payment instructions was further enhanced with new message standards, called MT 202 COV, which helps improve the screening of transactions by intermediary banks against AML/CFT and sanctions requirements.*



Source: CPML.

**3. The analysis of payment messages could help mitigate risk from wire stripping, which involves the changing or removal of material information from wire payments and instructions used to identify sanctioned countries, individuals, and entities.** As illustrated in recent incidents, the manipulation of payment messages that support international funds transfers through correspondent banking could come into violation of laws or regulations (<http://www.dfs.ny.gov/about/ea/ea120806.pdf>). This could lead to regulatory fines or even the temporary suspension of commercial banks from domestic payment systems in some countries. Wire stripping practices conceal or remove the true originators to avoid sanctions-monitoring programs. The analysis of the key attributes embedded in payment messages, such as beneficiary and remitter details, help identify and mitigate risks from any wire stripping activities. However, this has to be done with improvements in the compliance culture, staff capacity in identifying wire stripping, and internal processes and controls.

## Annex II. CBR Loss in Pacific Islands and Remittances Concerns

Table 1. Survey on the Consequences of CBR Withdrawal: Authorities' Views			
	Are relationships with correspondent banks becoming more difficult?	Are money transfers becoming costlier and complex to execute? 1/	Is repatriation of remittances to your country becoming costlier and burdensome?
<b>Fiji</b>	CBRs have remained broadly intact. The main challenge lies in the local banks' ability to generate sufficient transaction volumes to warrant a continuation of CBRs.	Pricing and execution of money transfers have remained reasonable despite the termination of relationships with remittance agents by the two major banks.	The cost of remittances to Fiji, especially from New Zealand, have increased since mid-2015.
<b>Kiribati</b>	No. However, there is anecdotal evidence of increased compliance costs.	No	No
<b>Marshall Islands</b>	The country's sole domestic commercial bank is at risk of losing its U.S. CBRs.	No, however, the loss of the CBR will have strongly negative consequences as the MTO operators rely on the domestic bank for remittances.	No
<b>Palau</b>	The loss of CBRs has not been an issue in Palau as the three U.S. FDIC-insured banks conduct all foreign transactions in the country.	No	No. The remittance sector is very small in Palau.
<b>Papua New Guinea</b>	Level of compliance to maintain CBRs is increasing and continues to be so annually, thus the increased costs. Certain institutions lost CBRs, others have had difficulties securing these relationships while others had to close or impose stringent requirements on remittance service providers to maintain their CBRs.	Money transfers are mainly done by commercial banks and authorized dealers and are becoming costly. This is due to costs associated with compliance requirements as CBRs and compliance requirements by the local regulator. Also, remittance services are provided by two commercial banks and apply stringent requirements.	The amount of remittances coming into PNG would be less than outbound payments and not considered costly.
<b>Samoa</b>	Although CBRs have largely been maintained, they are increasingly at risk. Non-compliance with FATCA has also led to loss of a CBR for one local bank.	The environment for MTOs has become more difficult, with MTOs facing account closures and imposition of complex requirements by banks.	Yes, the cost of remittance has increased recently. MTOs whose accounts have been closed are unable to serve their customers as quickly or as cost effectively before.
<b>Solomon Islands</b>	The number of CBRs has declined. In addition, a major regional bank exited and was subsumed by a local bank, which increased CBR concentration.	A few small MTOs have ceased operations.	The closure of some MTOs is beginning to have an impact on the cost of sending remittances.
<b>Tonga</b>	Establishing CBRs with U.S. banks has become more difficult. One Australian bank has agreed to open USD correspondent bank accounts for local banks.	Most of the bank accounts of money remitters' agents in Australia and New Zealand have been closed.	The cost of remittances from New Zealand to Tonga has increased.



<b>Tuvalu</b>	Tuvalu's largest bank, the NBT, has maintained the key working international CBRs, but access to some currency clearing services is complicated.	Yes	No
<b>Vanuatu</b>	Though the loss of CBRs has not emerged as a serious issue, inclusion in the FATF list may pose some difficulties in cross-border payments and trade finance.	The cost of money transfers has been increasing until ANZ lowered the cost. But the cost remains high as receiving banks also charge some fees.	The repatriation of remittances to Vanuatu has been costly for seasonal workers and those providing financial assistance to families in Vanuatu.
1/ Refers to all money transfers, including trade-related transfers and remittances.			
Sources: Alwazir, Jihad, et.al, IMF Working paper.			

## Annex III. CBR and Remittances: Country Vulnerability Matrix

Figure 1. CBR Loss and Remittances (Country Vulnerability Matrix)

	Change in number of active CBRs	Change in Cost of remittances		Change in Remittance value	Remittances / GDP	Access to financial services	Loss in number of active CBRs	Increase in Cost of remittances	Decrease in remittance value	High Remittances / GDP	Limited Financial access	Cost of Remittances <sup>1</sup>					
	Change between 2012-2015					2015						2011	2012	2013	2014	2015	2016
CBR impact + macro-criticality (remittances)																	
Gambia, The	-18%	18%	28%	20%	10%							12.4	11.5	14.0	13.9	13.5	18.5
Jamaica	-5%	17%	9%	17%	22%							7.6	7.4	7.9	8.0	8.6	8.1
Jordan	-11%	9%	39%	14%	38%							5.9	4.7	4.9	4.7	5.2	5.1
Lebanon	-9%	4%	12%	15%	55%							9.0	8.8	9.4	9.4	9.1	9.2
Lesotho	-4%	21%	-34%	18%	10%							9.7	9.2	11.8	13.1	11.1	11.2
Sri Lanka	-2%	16%	17%	9%	29%							5.7	5.6	7.4	6.6	6.5	6.3
Tonga	-8%	-26%	0%	28%	37%							11.2	10.6	9.3	10.6	7.9	8.4
CBR impact + macro-criticality (financial inclusion)																	
Botswana	-3%	38%	72%	0%	25%							11.2	10.3	11.4	14.1	14.3	16.8
Egypt, Arab Rep.	-13%	38%	-5%	6%	12%							4.2	4.8	4.6	5.3	6.6	6.4
Malawi	8%	29%	36%	1%	6%							11.2	10.3	16.3	14.5	13.3	16.5
Mozambique	1%	32%	13%	1%	9%							13.6	10.3	11.4	14.1	13.6	14.1
Nigeria	12%	-14%	0%	4%	14%							7.7	8.7	8.5	6.1	7.5	7.3
Sierra Leone	-4%	-38%	-5%	1%	3%							13.2	9.8	9.2	7.1	6.1	9.7
Swaziland	-6%	38%	-23%	1%	22%							9.5	8.7	11.4	13.7	12.1	11.2
Tunisia	-7%	-35%	4%	5%	31%							11.3	12.5	11.8	10.4	8.1	9.1
Zambia	4%	80%	-21%	0%	10%							7.5	7.8	12.0	12.7	14.0	12.4
No CBR impact, but macro-criticality																	
Albania	-6%	-3%	2%	9%	42%							8.9	7.8	8.9	8.2	7.6	7.5
Armenia	1%	-15%	-22%	14%	53%							2.0	1.7	1.4	1.3	1.4	1.3
Dominican Republic	3%	-19%	22%	8%	29%							6.3	7.4	6.7	5.8	6.0	6.1
El Salvador	10%	-19%	10%	17%	29%							6.0	5.6	4.5	4.5	4.5	4.8
Georgia	13%	-52%	-18%	10%	58%							2.7	2.4	2.0	1.5	1.2	1.2
Guatemala	-2%	-8%	31%	10%	58%							5.1	5.5	4.5	4.8	5.0	5.3
Guyana	2%	9%	-37%	9%	19%							9.2	8.2	8.6	10.2	8.9	8.5
Haiti	1%	5%	36%	25%	3%							7.2	8.0	7.8	6.8	8.5	6.2
Honduras	-6%	-36%	26%	18%	38%							5.9	5.9	4.6	1.5	3.7	4.3
Kyrgyz Republic	2%	-29%	-17%	25%	21%							2.4	2.0	1.9	1.6	1.4	1.3
Mali	5%	-38%	8%	7%	8%							9.4	9.4	7.9	6.9	5.8	5.4
Moldova	-4%	-18%	-23%	24%	32%							5.8	4.8	5.3	4.9	3.9	3.9
Nepal	8%	-65%	40%	32%	14%							8.4	8.5	4.1	5.1	2.9	4.5
Nicaragua	2%	0%	18%	9%	14%							5.3	4.6	4.3	4.6	4.6	4.7
Pakistan	-5%	-5%	38%	7%	14%							4.9	4.8	4.6	4.8	4.5	4.7
Philippines	-7%	-21%	22%	10%	21%							7.5	6.8	5.6	5.2	5.3	5.5
Samoa	5%	-20%	-13%	18%	47%							10.4	10.2	7.6	8.6	8.2	8.2
Senegal	-1%	-30%	0%	12%	7%							7.3	7.4	5.6	5.8	5.2	4.8
Tajikistan	15%	-17%	-38%	29%	12%							2.7	2.1	2.1	1.9	1.8	1.6
Vietnam	4%	-9%	30%	7%	16%							6.6	7.5	6.0	6.1	6.8	6.4
CBR impact, but NO macro-criticality																	
Mexico	10%	-22%	12%	2%	41%							6.5	7.0	5.0	4.7	5.4	5.7
South Africa	2%	13%	-24%	0%	45%							8.5	9.7	11.5	11.4	10.9	9.4
Thailand	3%	-21%	11%	1%	64%							9.7	11.6	9.5	9.7	9.2	10.6
Turkey	4%	1%	-26%	0%	60%							7.7	7.6	7.3	7.5	7.7	8.2
Vanuatu	-4%	74%	18%	4%	42%							12.6	9.0	11.2	12.8	15.7	16.8

Source: WB Remittance Cost Database, Staff calculations.

<sup>1</sup> Reflects fixed sample across years, in percent of transferred amount, and refers to transfer of USD200 in less than an hour, weighted across source by bilateral remittances. Red denotes vulnerabilities above cross country averages based on the first five data columns. Country sample restricted by availability in the combined database (CPMI 2016, World Bank Remittances Prices Worldwide, World Bank Migration and Remittances Database) used in the analysis.

## Annex IV. Country Examples and Caribbean Initiative

**1. Fund staff are testing a tailored, prioritized, and sequenced approach to developing responses in some countries and regions affected by CBR withdrawal.** Staff have provided advice to countries, including Angola and Samoa, to better understand the nature, scale, and scope of CBR withdrawal, to identify specific drivers, and to develop targeted and prioritized responses. A similar approach could be followed in other countries such as Belize. Finally, Fund staff have recently launched a Caribbean Initiative to develop regional responses to the withdrawal of CBRs in the Caribbean region, with a first event which took place on February 22, 2017.

### A. The Withdrawal of CBRs in Angola

**2. The decision to terminate CBRs in Angola was likely driven by different factors operating concurrently** (Angola, 2016, staff report). Retrenchment by global banks since the GFC had led to a reconsideration of the geographical reach of their business models in light of changed global macroeconomic conditions, regulatory demands, banks' own risk management requirements and the perception of Angola as a higher risk country, had all played a part in a withdrawal of direct USD CBRs.

**3. Angolan respondent banks had found alternative payment channels, helping mitigate the adverse macro-financial impact of the withdrawal of CBRs.** There had been a greater use of nested CBRs in USD through intermediary banks in countries such as Portugal and South Africa. In addition, there had been a much greater use of euro CBRs for payment flows out of Angola.

**4. Staff advised the Angolan authorities to consider undertaking a number of measures.** To help reduce the perception of Angola as a higher risk country, it would be key to: (i) continue strengthening the supervisory and regulatory prudential and AML/CFT framework to address existing legal deficiencies, including with regard to preventive measures for politically exposed persons; (ii) undertake a risk-based supervision of financial institutions; and (iii) enhance the understanding between global correspondent and Angolan respondent banks on information needs under a risk-based approach.

**5. The Angolan authorities had been actively involved in pursuing high-level dialogue with home authorities of global correspondent banks to better understand regulatory expectations around CBRs.** Work has been underway to strengthen supervisory and regulatory prudential frameworks and enforcement in line with regional and global peers. In addition, there had been open public-private sector dialogue on addressing the withdrawal of CBRs and strengthening AML/CFT frameworks through various local roundtables, workshops and at regional groups. Work had been underway at the central bank through a regular data questionnaire and analysis of CBR payment data. The Fund also had provided TA to better understand the nature, scale, and scope of CBR withdrawal and to help fine-tune policy responses.

## B. The Withdrawal of CBRs in the Asia and Pacific Region

**6. Staff engagement with the authorities of the Asia and Pacific region has been useful to understand the challenges facing small states in the region** (Alwazir, et.al.). These challenges were highlighted in a survey conducted in June–July 2016 (see Annex II). In Samoa, Tonga, and Fiji, closure of MTO accounts at home and in Australia and New Zealand were occurring with increased frequency. In other countries—such as Kiribati, Marshall Islands, Samoa, Tonga, and Tuvalu—survey responses indicated that CBRs had been withdrawn or were increasingly strained and that the consequences were primarily manifesting themselves in the remittance sector, rendering the remittance system increasingly fragile.

**7. Weaknesses in AML/CFT compliance in the context of high levels of remittances, and non-compliance with the U.S. Foreign Account Tax Compliance Act (FATCA) were contributing to banks' decisions to withdraw CBRs.** MTOs' compliance with customer due diligence requirements is weak and hampered by the lack of availability of formal means of identification in many small states that do not issue national identification documents.

**8. Fund staff is in the process of delivering TA to Samoa, using it as a pilot to explore solutions, including interim measures to reduce and mitigate CBR disruptions in the region.** Discussions with Samoa focused on five key interventions to enhance the effectiveness of its compliance regime:

- Develop a national strategy for AML/CFT and considerably increase the number of AML/CFT specialists throughout the financial and legal system to improve compliance. This is a critical step to increase the effectiveness of the AML/CFT regime and would include updating legislation, implementing the Asia/Pacific Group on Money Laundering mutual evaluation Assessment recommendations, and encouraging active engagement with key stakeholders enhancing communication and providing updates on the AML/CFT framework.
- Upgrade the sanctions regime. While there appears to be low risk of terrorism-related activities in Samoa, implementing a sanctions framework would enhance confidence in CBRs. A subscription by the Financial Intelligence Unit (FIU) to an AML/CFT utility to disseminate updates on sanctioned individuals and corporations, to the financial sector including the Samoa International Finance Authority for off-shore center registration checks and MTOs would reduce costs and enhance confidence in the system.
- Ensure compliance with FATCA, through negotiation of an intergovernmental agreement (IGA) with the U.S. Treasury on FATCA implementation. Such an agreement would reduce the risks and costs for local banks and potentially help reduce CBR withdrawal.
- Establish a national database—a KYC utility—to enhance compliance and reduce costs. The database would include KYC data on senders and receivers of remittances. The proposed KYC utility to be hosted by the FIU, which should have the necessary legal authority to collect data would also help address privacy concerns. By providing a readily available tool

to verify customers' information, the database would both enhance compliance and reduce costs.

- Document and emphasize the limited links between the MTO remittance channel and the off-shore financial sector and other companies, which would help ease correspondent banks' concerns over the MTO remittances channel.

**9. The results of Samoa's initiative could assist other small states in the region.** Collecting KYC data on individuals receiving or sending remittances through MTOs, including KYC data on banks' customers and beneficial ownership information for companies, may be possible given the relatively small population sizes of the islands. A utility within the FIUs, which are already established in many of these countries, could help address correspondent banks' concerns about AML/CFT compliance and privacy protection.

## C. The Withdrawal of CBRs in Belize

**10. The loss of CBRs has been a major challenge for Belize** (Belize 2016 Staff Report and Selected Issues paper). Major global banks terminated around 22 CBR accounts (out of 31) in 9 of Belize's 11 commercial and off-shore banks in 2015 and 2016. Only a large Canadian-owned bank (19 percent of the system's assets) had not lost any CBRs. The Central Bank of Belize had also lost three of its five CBRs in the same period, including one that was used to process selected wires for banks that lost CBRs. As a result, transaction costs and processing times had increased substantially.

**11. The impact of the loss of CBRs has been contained partly by actions taken by the central bank, including assisting in temporary processing cash letters and wires using its own CBRs.** In addition, more recently, all domestic banks had been able to replace some of the lost CBRs, but some of these new CBRs were apparently temporary solutions. These were mostly wire arrangements with small financial institutions and nonbank financial service providers, smaller than Belizean banks in terms of assets. The risks of additional CBR losses have not diminished.

**12. While there appears to be no single factor that can explain the loss of CBRs, a set of measures would have helped reduce the risk of further loss of CBRs.** They included (i) more effective implementation of the AML/CFT framework by the authorities; (ii) stricter licensing and robust prudential requirements; (iii) the adoption by respondent banks of more rigorous customer due diligence and transaction monitoring systems to facilitate information sharing with correspondent banks in a timely manner; (iv) a closer engagement between correspondent and respondent banks, in which the former are more transparent about their customer due diligence expectations and can provide TA and training in these areas; and (v) the consolidation of transactional traffic through fewer correspondent banks to generate sufficient volume.

## D. IMF Caribbean Initiative to Address the Withdrawal of CBRs

**13. In February 2017, Fund staff organized a closed-door roundtable bringing together global correspondent and respondent banks, and other stakeholders to discuss practical and actionable regional solutions to CBR withdrawal in the Caribbean.** The roundtable marked the launch of a collaborative initiative between the Caribbean and the IMF to develop regional responses to address CBR withdrawal in the region. Two additional regional events over the next 12 to 18 months are contemplated under the initiative to further develop regional solutions and take stock of their implementation. The roundtable, hosted by the Caribbean Development Bank (CDB), presented an opportunity for banks to share their experiences and discuss the feasibility and impact of industry-led solutions to address CBR issues. Overall, the discussions confirmed that key drivers of withdrawal relate to concerns regarding respondent banks' ability to manage risks, profitability, the general business and regulatory environment and meeting regulatory expectations.

**14. Participants identified strengthening respondent banks' capacity to manage risks as an immediate priority.** This can take the form of enhanced communication among banks to foster a common understanding of risks and how to manage them, and also provision of targeted training and TA to strengthen respondent banks' capacity by correspondent banks and the CDB. In the longer term, this can be complemented by automation of due diligence process by small respondent banks, subject to resource availability. Participants considered solutions such as KYC utilities, LEI, Fintech and, in some instances, volume-based pricing and bundling of services to be useful, but to have limited impact and take time to implement. Switching to CBRs in other currencies was deemed irrelevant in a region trading primarily in USD, and the use of insurance mechanisms as nonviable to address reputational or enforcement risks.

**15. To the extent respondent banks' capacity to manage risks remains weak despite the above efforts, consolidation of transactional traffic and reconsideration of some high risk business lines were viewed as solutions with significant potential impact to address correspondent banks' concerns.** The consolidation of transactional traffic could be achieved through downstreaming and consolidation of small-sized banks. Downstreaming would involve the correspondent bank having a relationship with an intermediary bank, which has relationships with other banks. Assets and capacity of the intermediary bank, which can be an existing or new bank, should support robust compliance risk management programs to monitor its respondent banks' transactions, and ensure transparency and flow of information to the correspondent bank. This approach is already gaining traction in the region. Consolidation of small-sized respondent banks in the Caribbean could help ensure sufficient level of transactions flows with correspondent banks, and economies of scale for due diligence processes. However, this solution may not address regulatory concerns at a country level and could increase costs with implications for financial inclusion. If respondent banks, particularly those small-sized ones, do not have capacity to manage risks associated with some high-risk businesses or services (e.g., online gaming and off-shore businesses), they would need to consider terminating those businesses or services in order to keep the CBRs with correspondent banks. This may lead to a transfer of these high-risk businesses or services to banks with more robust risk management and control systems.

**16. At the regional level, participants considered the consolidation of AML/CFT supervision and effective implementation of standardized AML/CFT regulations as a key solution in the longer term.** These measures would help correspondent banks manage risks by providing a level playing field. While the AML/CFT regulations in the region have generally been harmonized, focus should be on strengthening governance arrangements and capacity of regional supervisors to ensure effective implementation of those regulations. Views regarding establishing a regional correspondent bank in the U.S. and setting up a regional information repository were mixed, particularly since these measures would not necessarily address underlying risk issues.

**17. In case of emergency situations, the use of central banks' own CBRs was seen as the most effective solution, but could give rise to significant moral hazard and reputational risks.** Mixed views were expressed regarding solutions such as establishing regional payment arrangements, establishing special payment corridors for certain categories of customers, or subsidizing compliance costs.

**18. Participants strongly encouraged the Fund to continue to use its convening power to facilitate dialogue among all stakeholders and to provide TA and training in collaboration with regional development banks.** Building on the successful outcome of this roundtable, staff plans to hold the second event later this year to follow up on implementation of the concrete solutions identified by participants. While continuing to provide AML/CFT TA and training at the domestic level, staff will also provide training to the CDB,<sup>1</sup> leveraging the Fund's technical assistance center in the Caribbean.

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<sup>1</sup> Training to officials of the CDB has been approved by the Board Decision DEC/A/13710.



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