

IMF STAFF DISCUSSION NOTE

The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action

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Glossary

AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
ASBA	Association of Banking Supervisors of the Americas
CBR	Correspondent Banking Relationship
CPMI	Committee on Payments and Market Infrastructures
FATF	Financial Action Task Force
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
MENA	Middle East and North Africa
TA	Technical Assistance

EXECUTIVE SUMMARY

Correspondent banking relationships (CBRs), which enable the provision of domestic and cross-border payments, have been terminated in some jurisdictions following the global financial crisis. In recent years, several countries have reported a reduction in CBRs by global banks. Pressure on CBRs has been associated with restricted access to financial services by certain categories of customers, business lines, jurisdictions or regions. Survey and other available evidence indicates that smaller emerging markets and developing economies in Africa, the Caribbean, Central Asia, Europe and the Pacific as well as countries under sanctions may be the most affected.

Individual banks may decide to withdraw CBRs based on a number of considerations. Generally, such decisions reflect banks' cost-benefit analysis, shaped by the re-evaluation of business models in the new macroeconomic environment and changes in the regulatory and enforcement landscape, 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. These factors inform banks' risk and reputational cost perceptions. Further pressures to withdraw CBRs may arise where regulatory expectations are unclear, risks cannot be mitigated, or there are legal impediments to cross-border information sharing. These factors operate concurrently, although their relative significance varies case-by-case.

While the withdrawal of CBRs has reached a critical level in some affected countries, which can have a systemic impact if unaddressed, macroeconomic consequences have not been identified so far at a global level. Pressure on CBRs could disrupt financial services and cross-border flows, including trade finance and remittances, potentially undermining financial stability, inclusion, growth, and development goals. The current limited economic consequences partly reflect the ability of affected banks to rely on other CBRs, find replacements, or use alternative means to transfer funds. Still, in a few jurisdictions, pressure on CBRs can become systemic in nature if unaddressed.

Coordinated efforts by the public and private sectors are called for to mitigate the risk of financial exclusion and the potential negative impact on financial stability. An enhanced understanding of the phenomenon, improved data collection, and continued dialogue among stakeholders are imperative to developing appropriate responses tailored to individual country circumstances. Timely implementation of the Financial Stability Board's 2015 action plan endorsed by the G20 Summit will be critical. Home authorities of global banks should communicate their regulatory expectations and affected countries should continue strengthening their regulatory and supervisory frameworks to meet relevant international standards, with the help of technical assistance where needed. Clarifying these standards, including on AML/CFT, could help promote a baseline for regulatory expectations. Industry initiatives could be pursued to facilitate customer due diligence and help reduce compliance costs. In countries facing a severe loss of CBRs and diminishing access to the global financial system, the public sector may consider the feasibility of temporary mechanisms ranging from regional arrangements to public-backed vehicles to provide payment clearing services. The IMF staff has been supporting member countries in addressing the CBR withdrawal to promote financial inclusion and ensure financial stability.

I. INTRODUCTION

1. A number of emerging markets and developing economies have reported a reduction in correspondent banking services by global banks in recent years. While a reduction in access to financial services by certain categories of customers and business lines is not a new phenomenon, the more recent manifestation of this reduction involves a large-scale withdrawal of correspondent banking relationships (CBRs).² Survey evidence and information gathered in the context of IMF surveillance confirm instances of withdrawal of CBRs following the global financial crisis, with some jurisdictions and regions particularly affected.

2. The potential factors behind the withdrawal of CBRs are multiple and they operate concurrently. The withdrawal of CBRs generally reflects banks' business decisions based on their cost-benefit analyses. Therefore, understanding trends in CBRs requires recognizing banks' evolving business models against the backdrop of macroeconomic developments and the broader decline in cross-border lending since the global financial crisis (IMF 2015), analyzing the evolving regulatory expectations and enforcement landscape; and distinguishing "wholesale" CBR withdrawals from a case-by-case termination in services.

3. Continued pressure on CBRs could potentially disrupt financial services and cross-border flows of money. The impact of the withdrawal of CBRs on certain jurisdictions can become systemic in nature if unaddressed. It could disrupt financial services, including trade finance and remittances, and lead to financial exclusion for certain categories of customers, particularly Money or Value Transfer Services and Non-Profit Organizations, which serve vulnerable segments of the population. More generally, the risk of a jurisdiction completely losing access to the global financial system would warrant policy actions. To mitigate this risk, in line with the Financial Stability Board (FSB) action plan to assess and address the decline in correspondent banking unveiled in 2015 and endorsed by the G20 Summit, there is a need to better understand the scope, scale and implications of this phenomenon, and address the drivers that are adding pressure on CBRs and leading to the exclusion of certain categories of customers (FSB 2015).

4. This Staff Discussion Note has six sections. Section II describes the existing evidence on and consequences of the withdrawal of CBRs. Section III discusses the drivers of the phenomenon. Section IV presents the responses from the international community. Section V describes the role that the IMF has been playing in addressing the withdrawal of CBRs. Section VI concludes on the steps to further mitigate potential negative spillovers from the withdrawal of these relationships.

² For instance, Money or Value Transfer Services and charities lost access to financial services in the early 2000s as a result of actions by global banks. In 2005, U.S. regulatory authorities issued a joint statement and interagency interpretive guidance on providing banking services to money service businesses operating in the United States, clarifying that banking organizations have flexibility to provide services to a wide range of money services businesses (U.S. Department of the Treasury Financial Crimes Enforcement Network 2005).

II. EVIDENCE AND CONSEQUENCES

A. Setting the Scene: The Withdrawal of Correspondent Banking Relationships

5. This Staff Discussion Note examines the evidence regarding the withdrawal of CBRs and draws out its implications. Correspondent banking, which enables the provision of domestic and cross-border payments, supports economic growth through international trade and cross-border financial activity, including remittances (Box 1). A wide range of phenomena have been associated with trends in CBRs since the global financial crisis. These include cutbacks in the number of CBRs; changes in the nature of correspondent banking services provided; with higher risk services being scaled back (for example, nested correspondent banking, payable-through accounts; see Box 1); growing market concentration; increasing costs; and cutbacks to correspondent banking services in specific foreign currencies, particularly U.S. dollars (CPMI 2015a).

6. Global banks' withdrawal of CBRs is often referred to as "de-risking." There is no consensus on the definition of "de-risking." At one extreme, this term covers a set of actions on the part of banks to effectively avoid the business and reputational risks altogether. This risk avoidance would typically occur on a wholesale basis, without a case-by-case assessment of the risk associated with individual customers, or the country or region involved, or as a result of an analysis indicating that the business relationship as a whole was no longer profitable. At another extreme, this term has been used more broadly to refer to any form of withdrawal of financial services. The indiscriminate use of the term "de-risking" to describe different types of events has been at times misleading and has confused the dialogue on the trends and drivers of the withdrawal or termination of CBRs.

Box 1. The Definition of Correspondent Banking

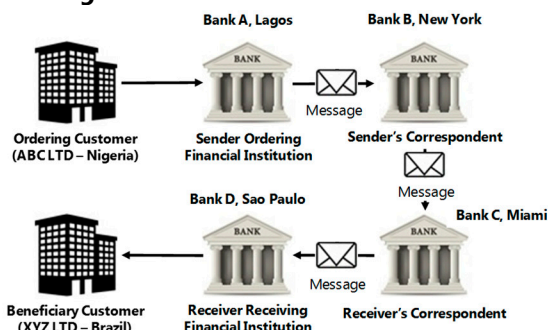
Correspondent banking is a bilateral arrangement, often involving a reciprocal cross-border relationship in multiple currencies. A correspondent banking arrangement involves one bank (the *correspondent*) providing a deposit account or other liability accounts, and related services, to another bank (the *respondent*), often including its affiliates. The arrangement requires the exchange of messages to settle transactions by crediting and debiting those accounts.

Correspondent banking enables the provision of domestic and cross-border payments. These relationships facilitate a range of transactions and services including the execution of third-party payments, trade finance, the banks' own cash clearing, liquidity management and short-term borrowing or investment needs in a particular currency.

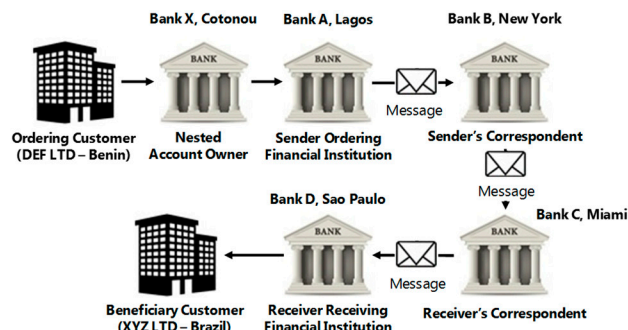
Correspondent banking services are provided in three main ways. First, in the most traditional form of correspondent banking, a respondent bank enters into an agreement with the correspondent bank to execute payments on behalf of the respondent bank and its customers. Second, "nested" correspondent banking refers to the use of a bank's correspondent relationship by several respondent banks. Third, payable-through accounts, also known as "pass-through" or "pass-by" accounts, are similar to nested correspondent banking, but in the case of these accounts the respondent bank allows its customers to access the correspondent account directly to conduct business on their own behalf.

Stylized Examples of Correspondent Banking Payment Transaction

Traditional Correspondent Banking



Nested Correspondent Banking



Sources: CPMI (2015a), Wolfsberg Group (2014).

B. Country Developments

7. Discussions with country authorities and surveys indicate that there is pressure on CBRs in some parts of the world (Figures 1 and 2).³ Surveys by the World Bank (2015a, 2015b), the IMF with the Union of Arab Banks (UAB) (2015), and the Association of Supervisors of Banks of the Americas (ASBA) (2015) indicate that smaller jurisdictions in Africa, the Caribbean, Central Asia, and Europe have been most affected. Authorities in several Caribbean jurisdictions have reported particular pressures on their CBRs (Box 2).⁴ In Asia and the Pacific, Pacific islands appear to have been most affected, with the decline in CBRs potentially undermining progress on financial inclusion (Box 3). In Africa, CBR withdrawal has occurred, for example in Liberia, while problems with banknote supply have surfaced in Angola (Box 4). In Botswana, concern about compliance with AML/CFT regulations has led some correspondent banks to close their accounts at the central bank, limiting the range of counterparties available for foreign exchange transactions and investment operations. To a lesser extent, pressure on CBRs is also seen in some larger economies in Latin America and Asia (including Mexico and the Philippines). In the Middle East and North Africa, countries under economic and trade sanctions are most affected by the withdrawal of CBRs (IMF and UAB 2015) (Box 5).

8. Although pressure on CBRs has reached a critical level in a few jurisdictions, so far the economic or financial stability impact has been limited, partly because financial institutions in affected countries have been able to find alternative arrangements. In many cases where CBRs have been lost, financial institutions have been able to find alternative arrangements including by relying on their remaining CBRs, finding replacement CBRs or using other means of transferring funds across borders. However, the ability of financial institutions to find replacement CBRs has varied. Authorities have reported that maintaining existing CBRs has come at a price, including (i) newly imposed minimum activity thresholds below which the account is closed, (ii) higher costs (often associated with due diligence) passed on to the consumer when establishing a new CBR, and (iii) pressure on the respondent banks to limit their exposure to certain categories of customers in order to maintain a CBR (for example, small banks have reported severing ties with Money or Value Transfer Services to maintain CBRs) (World Bank 2015a).

9. The withdrawal of CBRs also appears to have affected certain categories of customers and business lines. According to the results of the surveys undertaken by the IMF and UAB and ASBA, Money or Value Transfer Services, small and medium-sized exporters, and small and medium-sized domestic banks have been the most affected categories of customers. In addition, international wire transfers, clearing and settlement services and trade finance appear to have been particularly affected (World Bank 2015b). In Latin America, the reduction of CBRs is believed to have inhibited further financial integration, raised the cost of finance for small and medium-sized enterprises, and, in some cases, led to firms losing access to credit from U.S. exporters (IMF 2016). Moreover, in

³ These surveys are generally perception-based, and response rates vary. As with any survey-based evidence, the usual caveats of self-selection, non-response, and cognitive response biases apply.

⁴ The countries discussed in the various boxes on regional implications are not intended to represent a comprehensive sample of affected countries, but rather to highlight a few specific case studies developed through bilateral staff engagements with country authorities.

jurisdictions where Non-Profit Organizations play a sizable role in the economy and rely on financial services to receive funding and conduct their operations (for example, Somalia, West Bank and Gaza), withdrawal of CBRs could affect growth, poverty reduction, and security (Warden 2015a, 2015b; Center for Global Development 2015). Importantly, an increase in the concentration of correspondent banks and consequent reduction of CBRs could also push activities to the informal sector, raising transparency concerns (Center for Global Development, 2015).

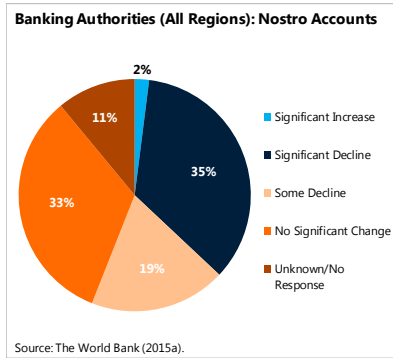
Views of Global Banks

10. Surveys and discussions with global banks confirm increased caution in maintaining CBRs and indicate that the global volume of correspondent banking transactions may be rising overall. While most U.S. global banks indicate that decisions to withdraw CBRs peaked two to three years ago, the withdrawal of CBRs continues for other banks, mostly those in Europe. Even though most cases of the withdrawal of CBRs involve U.S. banks, according to local and regional banks (World Bank 2015a), this is not surprising given the key role played by the U.S. dollar in the international financial system. Conversations with global banks also reveal that while the number of U.S. dollar CBRs of selected institutions decreased during 2010-14, and the composition of banks providing correspondent banking services has changed, there has been no effect on the volume of authorized credit lines. In fact, while the number of banks providing correspondent banking services declined in 2015, the volume of authorized credit lines increased, as did the value of transactions. In Europe, while the total value of turnover in correspondent banking accounts fell during 2007-10 following the global financial crisis and has not recovered to pre-crisis levels, the volume of correspondent banking transactions has been growing since 2010. However, the number of CBRs in the euro area has decreased steadily since 2002 against the background of a highly concentrated correspondent banking market. In addition, some large banks have begun to move away from correspondent banking to payment systems for low-volume/high-value payments following the introduction of the Single Euro Payments Area in 2014 (ECB 2015). Furthermore, some global banks have decided to exit a number of countries as part of a risk re-evaluation in the context of increased compliance costs.

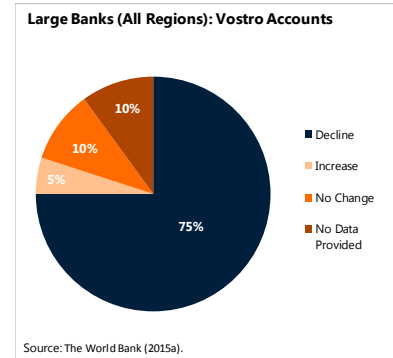
Figure 1. The Withdrawal of Correspondent Banking Relationships (CBRs)¹

Banking authorities and international, regional, and local banks have reported a reduction in CBRs, with the Caribbean particularly affected by the retrenchment of U.S. and U.K. banks.

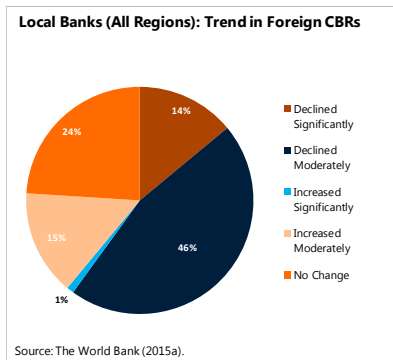
While about 55 percent of banking authorities reported a decline in CBRs²...



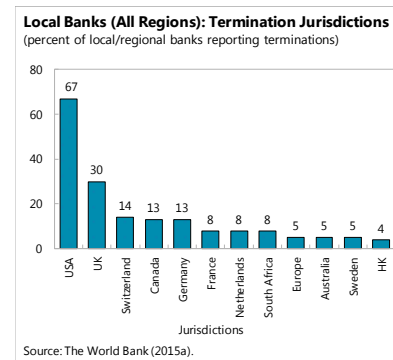
...75 percent of large global banks reported that they had withdrawn from CBRs²...



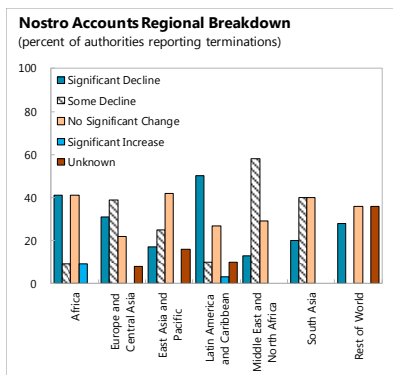
...and 60 percent of local banks reported a decline in CBRs.



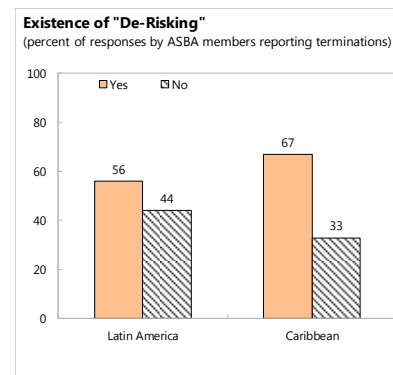
Local/regional banks reported that U.S. and U.K. banks have led the reduction in CBRs.



Authorities indicated that there has been a significant decline in the Americas, Africa, Europe, and Central Asia,...



...with the Caribbean being particularly affected.



Sources: World Bank 2015a; and ASBA 2016.

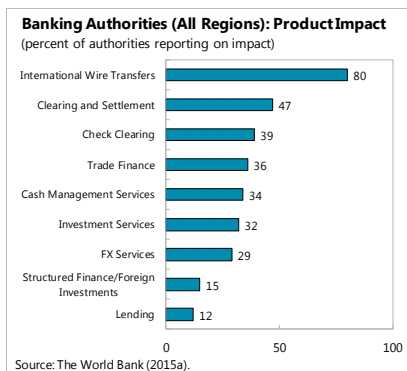
¹The evidence from World Bank 2015a covers the period from 2012 through mid-2015. The evidence from the Association of Supervisors of Banks of the Americas ASBA (2016) was collected in August 2015 covering an unspecified period.

² Nostro and vostro accounts are used to facilitate the settlement of foreign exchange and trade transactions. The account of the bank receiving the correspondent banking services is referred to as the nostro account; the vostro account is the account of the bank providing those services.

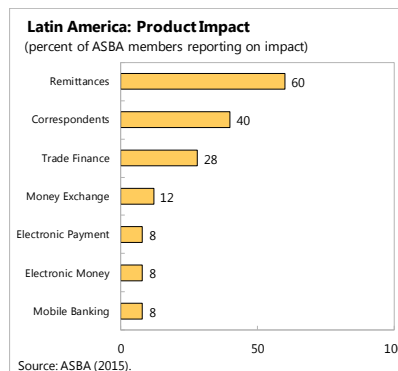
Figure 2. Consequences of the Withdrawal of Correspondent Banking Relationships (CBRs)¹

U.S. dollar wire transfers, remittances, and trade finance, including money or value transfer services, have been particularly affected. The evidence on increasing concentration is mixed.

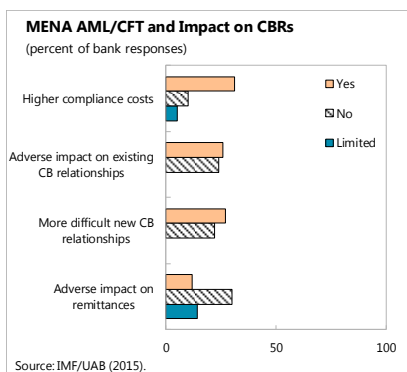
While 80 percent of authorities have indicated that U.S. dollar wire transfers have been affected...



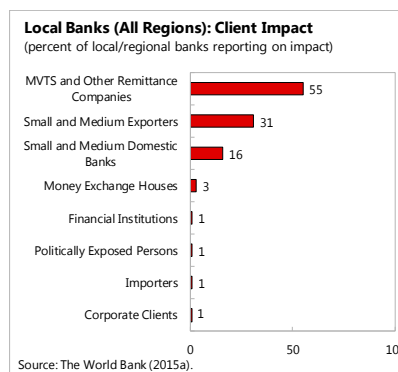
...in the Americas, 60 percent of ASBA members report that remittances have been affected.



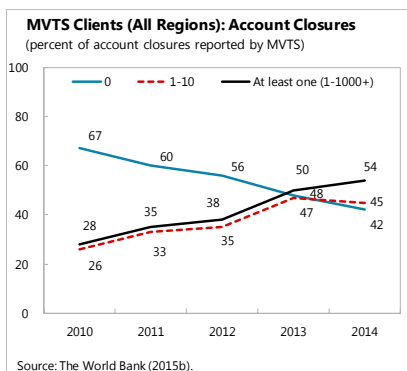
Higher compliance costs appear to have led to a decline in CBRs in the Middle East and North Africa (MENA).



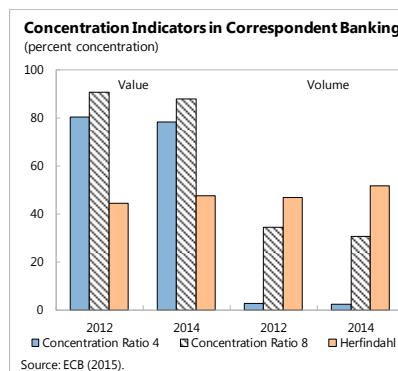
Local banks have reported that money or value transfer services and small and medium-sized exporters have been most affected...



...which is supported by closures of accounts of money or value transfer services.



Evidence of concentration in euro CBRs is mixed.



Sources: ASBA 2016, ECB 2015, IMF and Union of Arab Banks 2015, World Bank 2015a, World Bank 2015b.

1/ The evidence from the World Bank covers the period from 2012 through mid-2015 (World Bank 2015a), and from 2010 through 2014 (World Bank 2015b). The evidence from the Association of Supervisors of Banks of the Americas (ASBA) (2016) was collected in August 2015 covering an unspecified period. The evidence from IMF and the Union of Arab Banks relates to banks in MENA and was collected in early 2015 covering an unspecified period. The evidence from the ECB collected in March 2014 covered all correspondent banking transactions in euro booked on participating banks' accounts between March 1–31, 2014, and comparing that information with previous surveys.

Box 2. The Withdrawal of Correspondent Banking Relationships in the Caribbean: Selected Country Cases

Major global banks have recently terminated CBRs with many banks in the Caribbean or are considering doing so. At least 16 banks in the region across five countries have lost all or some of their CBRs as of May 2016. The loss of CBRs has had a varying impact across Caribbean countries depending on the size of the affected banks and the level of foreign presence in affected countries' banking systems. The full extent of the impact has yet to be quantified, but the unmeasured effect has been a loss in business confidence and in the ease of some basic transactions.

The main CBR providers in the Caribbean are located in the United States, Canada, and to a lesser extent Europe and the Caribbean. Several institutions in Barbados, The Bahamas, the Eastern Caribbean Currency Union, Guyana, Haiti, Jamaica, and Trinidad and Tobago have had CBRs terminated. Many of them have reportedly been able to find replacement CBRs or rely on their remaining ones. Reasons given for terminating the existing CBRs have included risks associated with the presence of offshore sectors in some of these countries or jurisdictions with concerns about supervision and legal frameworks, the inclusion of higher-risk categories of customers (for example, Money or Value Transfer Services, cash intensive firms, specialized professionals, and politically exposed persons), in respondent banks' customer base, a change in the correspondent bank's risk appetite and perceived lack of profitability of certain correspondent banking services. Facing pressure on their CBRs, some respondent banks have tried to mitigate the risk of losing access to such relationships by closing local accounts with their higher-risk customers.

In Belize, several banks have lost their CBRs. Only two of the country's nine domestic and international banks (representing 27 percent of the banking system's assets at the end of March 2016) have managed to maintain CBRs with full banking services. Other banks have found alternative relationships with non-bank providers of payment services or through nesting arrangements. The Central Bank of Belize has also lost two of its CBRs. While the overall size of deposits and lending in the country has not been affected, international banks' deposits have decreased significantly, with this decrease partly compensated by an increase in deposits in domestic banks. There has also been some displacement of customers toward the two banks that still have CBRs with full banking services.

Financial institutions in The Bahamas have experienced additional scrutiny of their CBRs, although only in a few cases has this resulted in temporary disruptions of correspondent banking services. Five financial institutions (representing about 19 percent of the assets of the banking system) have recently lost one or more CBRs. The Money or Value Transfer Services sector has also been affected, as well as various business lines, including credit card payments, cash management, investment services, clearing and settlement, international wire transfers and remittances. Although the impact has been limited so far, further pressure on CBRs could have an adverse effect on the financial sector and increase costs of outgoing remittances in the Caribbean. Indeed, The Bahamas is a source of remittances to other countries. In Haiti, for example, the impact of this spillover would be immediate, as about 75 percent of remittances from The Bahamas to Haiti are paid and received in the same day.

Source: IMF country desks.

Box 3. Correspondent Banking Relationships: Evidence from the Small States of the Pacific

The withdrawal of CBRs in the small states of the Pacific has put pressure on respondent banks to reconsider their customer base. Banks have terminated accounts of Money or Value Transfer Services, increasing the fragility of remittance corridors to *Samoa* (Box 7). The withdrawal of financial services risks undermining recent progress on financial inclusion and increasing the hand-carrying of cash in the region.

The limited number of banks operating in small Pacific states amplifies the risk and impact of the loss of CBRs. The financial sector tends to be small and dominated by foreign banks. In *Tuvalu*, the country's largest bank lost its long-term CBR with an Australian bank after the latter was taken over by another bank. In 2015, *Marshall Islands'* only domestic commercial bank was informed it would lose its CBR with a U.S.-based bank by the end of 2016 citing concerns about the cost of complying with new U.S. regulations. As of May 2016, however, the planned termination of the relationship was put on hold. In *Tonga*, all commercial banks have been able to continue normal correspondence banking activities with banks abroad. However, the authorities have expressed concerns about the potential effects of the withdrawal of CBRs on the cost of remittances.

Withdrawal of CBRs is affecting the ease and cost of remittance transactions. Remittances play a key role in Pacific islands, with inflows amounting to one fifth of GDP in some countries. While average remittance costs have always been higher for Pacific small states relative to other countries, the gap widened recently—particularly with respect to remittances from Australia and New Zealand. The increase in the cost of sending remittances combined with closures of Money or Value Transfer Services' bank accounts including in Samoa, Solomon Islands, and Tonga, is a source of concern.

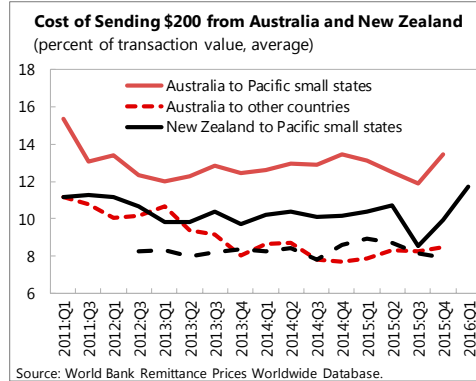
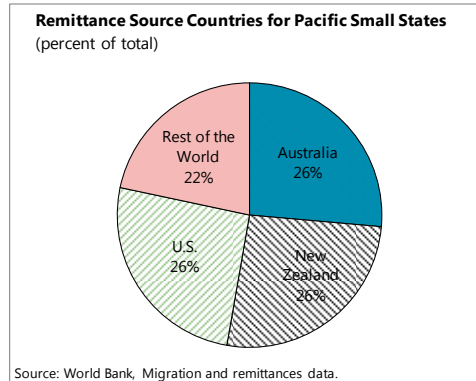
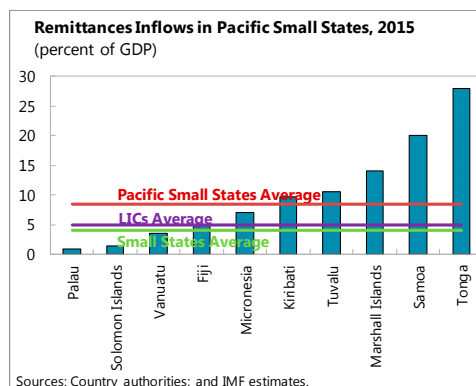
Improving AML/CFT compliance in the small states of the Pacific is necessary but insufficient to maintain the flow of remittances in the medium term. The current Money or Value Transfer Services low-cost business model is hard to square with the high cost of compliance with AML/CFT standards. Mobile banking solutions along with improved customer identification appear to be the way forward.

Source: IMF Country desks.

Commercial Banks in the Small States of the Pacific

Country	Australian Banks	U.S. Banks ¹	Other	Domestic Banks
Fiji	ANZ Westpac		Bank of Baroda (India) Bank South Pacific (Papua New Guinea) Bred Bank (Banque Populaire, France)	Home Finance Company
Kiribati	ANZ			
Marshall Islands		Bank of Guam		Bank of Marshall Islands
Micronesia		Bank of Guam		Bank of the FSM ²
Palau		Bank of Guam Bank of Hawaii Bank Pacific		Asia Pacific Commercial Bank Palau Construction Bank
Samoa	ANZ		Bank South Pacific (Papua New Guinea)	National Bank of Samoa Samoa Commercial Bank
Solomon Islands	ANZ		Bank South Pacific (Papua New Guinea)	Pan Oceanic Bank
Timor-Leste	ANZ		Caixa (Portugal) Bank Mandiri (Indonesia)	National Commercial Bank of Timor-Leste
Tonga	ANZ		Bank South Pacific (Papua New Guinea)	Tonga Development Bank Pacific International Commercial Bank
Tuvalu			MBF (Malaysia)	National Bank of Tuvalu Development Bank of Tuvalu
Vanuatu	ANZ Westpac		Bred Bank (Banque Populaire, France)	National Bank of Vanuatu

¹Sources: Country authorities; IMF staff compilation.
²Insured under the Federal Deposit Insurance Corporation scheme.



Box 4. Correspondent Banking Relationships in Africa: The Cases of Liberia, Angola, and Guinea

Certain countries in Africa have experienced the withdrawal of CBRs. The cases of Liberia, Angola and Guinea are described below.

Liberia has experienced significant loss of CBRs. Global banks have terminated 36 out of 75 CBRs in Liberia between 2013 and mid-2016, citing the country's risk rating, AML/CFT concerns, low volumes of transactions, and their lack of physical presence in the country. All Liberian banks have lost at least one CBR, with the most affected bank losing 78 percent of these relationships. With CBRs accounting for one-third of interbank activity in the country and about 60 percent of banks' income being sourced from non-interest revenue, loss of CBRs is affecting margins, particularly through lower trade financing. Seeking alternatives in other jurisdictions is costly, depressing profits further, and could affect transparency and efficiency, and limit the central bank's oversight of the transactions. As a result, processing U.S. dollar checks is now lengthier and costlier, with one major bank indicating a cost of US\$150 per check. In addition, a major Western bank severed its euro CBR with the Central Bank of Liberia in March 2014.

Angola has also been adversely affected by the loss of U.S. dollar CBRs. In December 2015, the only supplier of U.S. dollar bank notes to Angola discontinued this service. Another large global bank withdrew U.S. dollar CBRs with Angolan banks, while retaining clearing of the U.S. dollar payments for the central bank of Angola (BNA), as well as local kwanza business. A European bank stopped clearing customer payments in U.S. dollar two months later, but continued to provide letters of credit. As a result, a single European bank is now the sole provider of U.S. dollar CBRs to Angolan banks. Furthermore, only two Angolan banks have direct access to U.S. dollar CBRs. Other Angolan banks are offering U.S. dollar service payments through European banks, resulting in higher costs. BNA interventions in the foreign exchange market are now primarily in euros with many external trade transactions increasingly invoiced in euros. Bank customers have experienced increase in transaction costs as a result. The loss of U.S. dollar CBRs could further weaken the financial system in a country already struggling with the macroeconomic impact of lower oil prices, weak profitability and high levels of non-performing loans. Large firms that need access to U.S. dollars are migrating to the two remaining Angolan banks with U.S. dollar CBRs, putting pressure on the incomes of small and medium-sized Angolan banks. Settlement of international credit and debit cards, and cash management have been particularly affected. However, two banks with a specific investment banking, trade finance and credit card business model have sufficient scale in these activities to transact in U.S. dollars separately with European banks and other global counterparties without resorting to U.S. dollar CBRs.

Guinea has likewise experienced a loss of CBRs. Some 20 accounts of the central bank with seven foreign banks have been closed since 2009, with most of the closings concentrated during 2013-15. A survey conducted by the country's central bank indicates that all major banks in the country have suffered closures of CBRs with banks in the U.S., Europe, and South Africa. As a result of these closures, some banks, including the central bank, have reported a slowdown in their international trade operations. In response to the closures, banks envision using the services of their parent companies and branches abroad to conduct international financial transactions.

Source: IMF country desks.

Box 5. Correspondent Banking Relationships in the Middle East and North Africa

A joint IMF-Union of Arab Banks survey conducted in the spring of 2015 suggests that withdrawals of CBRs in the Middle East and North Africa (MENA) have had an impact on countries subject to trade and economic sanctions, Non-Profit Organizations and Money or Value Transfer Services. Survey responses from 17 countries showed that many banks (40 percent) were facing higher compliance costs and that some Money or Value Transfer Services had been cut-off (for example in the countries of the Cooperation Council of the Arab Countries of the Gulf), which could increase the cost of remittances and lead remittance flows to be channeled through non-regulated entities. The survey showed that many embassies and Non-Profit Organizations operating in MENA were reclassified to a higher risk category. Banks have reduced foreign currency transaction services to third parties, such as Money or Value Transfer Services, because the risks are difficult to manage.

The costs of doing business in MENA are reported to have risen as a result. Banks reported the need for much closer monitoring, including on the nature of the respondent bank's business activities; markets and customers; customers' customers; group, management and shareholder structure; and the quality of countries' regulatory and supervisory frameworks.

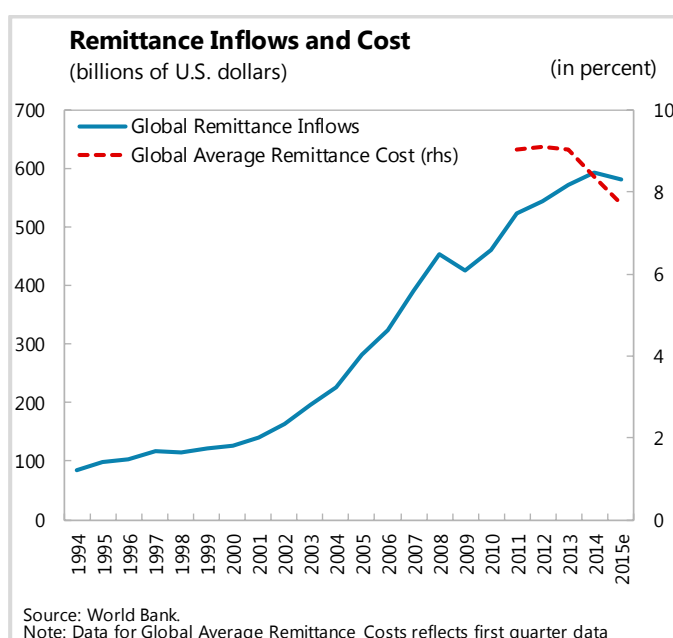
Countries under sanctions have been particularly affected. The survey indicated that about 10 percent of banks had closed relationships with respondent banks in countries in MENA that were under economic and trade sanctions or where there were material weaknesses in AML/CFT policies. To address these challenges, banks in the region are strengthening their procedures and processes, investing in infrastructure and staff training, and recruiting more compliance staff. Regional political and civil unrest has further driven some banks to enhance sanctions screening systems to better adjust to screening of politically exposed persons, sanctions list transactions and rapid changes to these lists.

Source: IMF and Union of Arab Banks 2015.

Remittances

11. The limitations suffered by Money or Value Transfer Services could have a negative impact on financial inclusion, given these services' crucial role in international remittances (World Bank 2015b). Indeed, in many markets, more than 90 percent of remittances are processed by Money or Value Transfer Services. Officially recorded remittances to developing countries amounted to US\$ 431.6 billion in 2015. Banks and Money or Value Transfer Services reported an increased trend in closures of accounts of Money or Value Transfer Services between 2010 and 2014.

12. A sudden stop of remittances in economies that rely on these flows could pose a significant threat to socio-economic stability. For example, 40 percent of households in Somalia rely on remittances and in Samoa, remittance flows amount to 20 percent of GDP. In the aggregate, remittances to developing economies have been growing since the global financial crisis, though the 0.4 percent growth in 2015 was the slowest since the crisis. The costs associated with remittances continue to decrease, on average (World Bank 2016). However, the regional variation is significant. Remittances to the Middle East and North Africa (MENA) region contracted by 0.9 percent in 2015, compared with 4 percent growth in 2014, while remittance flows to Europe and Central Asia plummeted by 20.3 percent, owing to the depreciation of the Russian ruble and the slowdown in economic activity in Russia, a major source of remittances for the region. In Asia and the Pacific, which is among the top remittance recipient regions, remittances have continued to grow over the past two years, but surveys suggest that account closures have adversely affected remittance costs and flows in rural and remote regions. In the Philippines, the central bank reported that 84 accounts among 32 Philippine remittance providers (including both banks and Money or Value Transfer Services) have been closed by 33 correspondent banks in 13 major remittance-sending countries. In Samoa, the cost of remittances has increased, and the closing of Money or Value Transfer Services accounts would potentially have a significant impact on financial inclusion in the country, as well as its economic growth (Box 6).



Box 6. Samoa: The Impact on Remittances Inflows

Samoa is a small Pacific economy dependent on remittances from a large diaspora in New Zealand, Australia, and the United States.

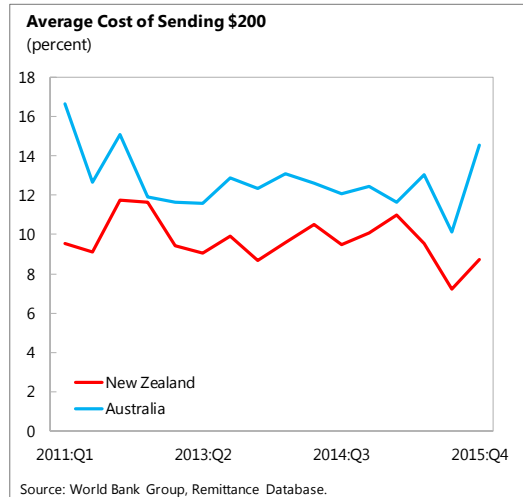
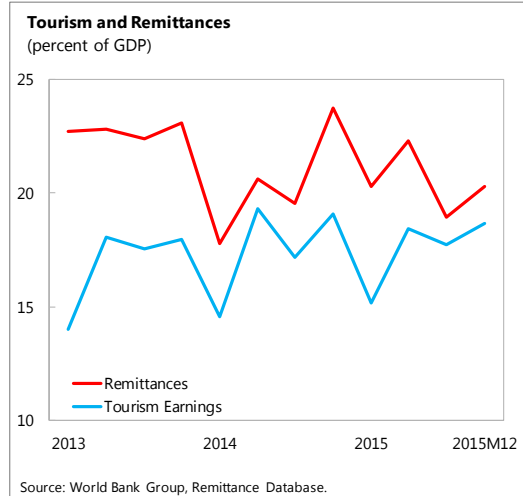
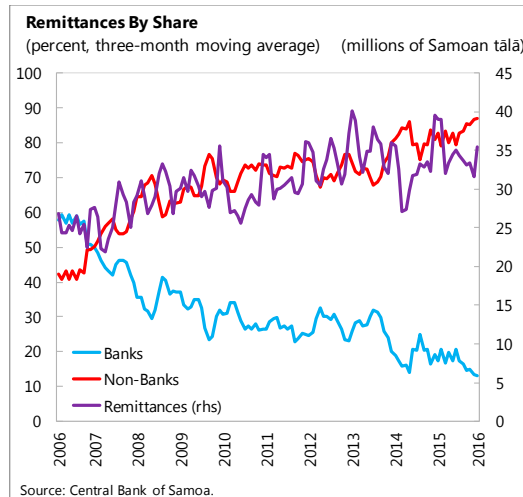
Samoa’s emigrants maintain close ties with Samoa and remittance inflows amount to 20 percent of GDP. Remittances are the main source of foreign exchange in Samoa and contribute to economic stability and resilience, especially in the aftermath of natural disasters.

Approximately 85 percent of the remittances are channeled through Money or Value Transfer Services, which offer a lower cost alternative for cash transfers compared to the banks.

Money or Value Transfer Services handle just over half a million inward money transfers per year, with an average size of just US\$ 270. Furthermore, Money or Value Transfer Services have a greater reach within the community, with the largest of such services having double the number of branches outside Apia than the four banks combined. Thus, the closure or curtailment of Money or Value Transfer Services potentially entails a significant impact for financial inclusion in Samoa.

The operating environment has become increasingly difficult and the average remittance cost has recently increased.

Bank accounts of Samoan-linked Money or Value Transfer Services agents in Australia and New Zealand have been closed. Banks cited pressure from global correspondent banks particularly those in the United States, which have increased their scrutiny of Australian banks and tend to view the remittance sector as generally high risk. Most Australian banks are taking a risk-based approach to providing services to remitters. However, the banks view the risk-based approach as placing them in a pseudo-regulatory role which is time consuming and costly. Other drivers of withdrawal include low levels of compliance by some Money or Value Transfer Services in both sender and receiver markets, and in some cases, significant efforts to improve AML/CFT compliance standards will be necessary.



Sources: Central Bank of Samoa; Mutual Evaluation Report, Samoa Bureau of Statistics; World Bank Group, Remittances Database; IMF staff calculations.

III. DRIVERS OF THE WITHDRAWAL OF CORRESPONDENT BANKING RELATIONSHIPS

13. While the factors leading to the withdrawal of CBRs are multiple and interrelated, these are ultimately individual business decisions. These drivers operate concurrently, and their relative significance varies case-by-case. Banks' cost-benefit analyses have been shaped by the re-evaluation of business models post-global financial crisis, including changes in the regulatory and enforcement landscape. The new macroeconomic environment, more stringent prudential requirements, and higher compliance costs are putting pressure on banks' profitability and weighing on their decisions to withdraw CBRs. Other evolving regulatory requirements, notably with respect to economic and trade sanctions, AML/CFT and tax transparency, and the current enforcement landscape also affect global banks' cost-benefit analyses and shape their reputational risk and cost perceptions. In addition, lack of clarity about the regulatory expectations, banks' concerns about their ability to manage risks and cross-border legal impediments to the implementation of regulatory requirements may result in a bank's decision to withdraw from a CBR (Figure 3).

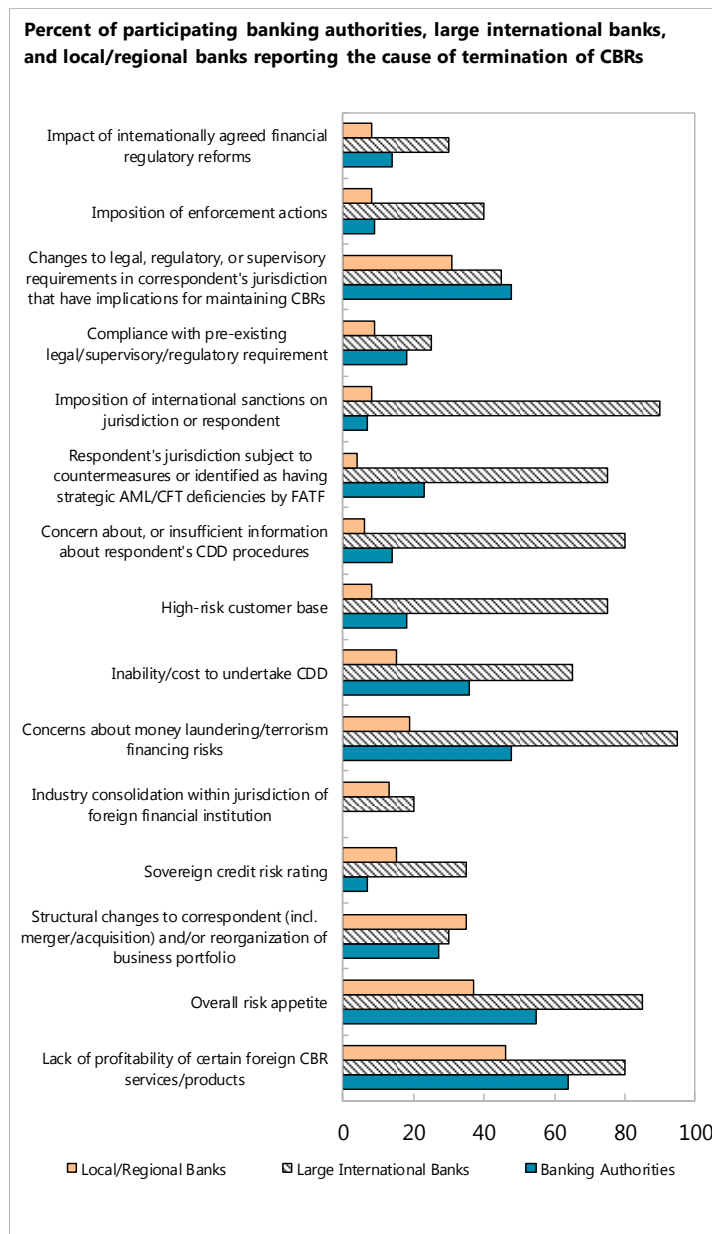
A. Re-evaluation of Business Models

14. Since the global financial crisis, 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). A combination of regulatory changes, weaknesses in banks' balance sheets, and macroeconomic factors can explain this shift. Direct cross-border lending as a share of total banking assets has declined mostly due to the retrenchment of European banks, while the share of local lending by foreign bank affiliates has remained steady. Global banks in particular have refocused their activities on some key markets, leaving space for other banks to expand. As a result, intra-regional financial linkages have deepened, particularly in Asia.

15. Global regulatory reforms have entailed a significant increase in banks' capital and liquidity requirements, raising the cost of capital. The implementation of these reforms has been a key building block in restoring global financial stability and has strengthened the resilience of the banking sector. At the same time, the more rigorous capital and liquidity requirements have increased banks' cost of holding risk in their balance sheets. High-volume, low-return, and balance-sheet-intensive businesses, such as correspondent banking, have become less attractive contributing to a further re-evaluation of risk and profitability by banks across all lines of business (Sheets 2015). High fixed costs of compliance create natural economies of scale fostering increased concentration. Smaller jurisdictions, markets, products, activities, and even individual customers have been particularly affected as they moved away from the "core" of banks' main operations (Ernst and Young 2013). That said, for several banks, correspondent banking remains an important business.

Figure 3. Causes of Termination and Restriction of Correspondent Banking Relationships¹

According to survey respondents, issues related to compliance with customer due diligence requirements are the main cause of the decline in CBRs.



Source: World Bank (2015a).

Note: Respondents were allowed to choose multiple options.

¹ The evidence from the World Bank (2015a) covers the period 2012-mid-2015.

16. Significant compliance costs may also result in the withdrawal of CBRs. Surveys indicate that compliance costs have been increasing with changes in the regulatory landscape over the past 15 years, and are perceived as contributing to the withdrawal of CBRs (KPMG 2014a; ECB 2015; World Bank 2015a).⁵ In particular:

- **Economic and trade sanctions:** The effective and timely implementation of multilateral and bilateral economic and trade sanctions requires that financial institutions establish effective customer due diligence processes, which weighs on compliance costs.
- **AML/CFT:** The 2012 revised Financial Action Task Force (FATF) standard for AML/CFT places greater emphasis on assessing risks and applying a risk-based approach. Jurisdictions and regulated sectors are required to identify, understand, and assess money laundering and terrorist financing risks, and to take actions to ensure these risks are effectively mitigated. As regulated sectors transition away from previously more rules-based systems to a greater emphasis on assessing risks and implementing a risk-based approach, this can create additional costs. Notably it may lead to the overcautious use of enhanced due diligence measures resulting in an unnecessary increase in compliance costs.
- **Tax transparency initiatives:** Business relationships with customers from certain jurisdictions could represent a risk of additional cost, which may lead to banks' decisions to terminate such relationships.⁶ In some African countries, for example, banks have retrenched from clearing U.S. dollar payments largely because of additional transaction costs stemming from extraterritorial U.S. tax legislation.

17. Macroeconomic conditions are putting pressure on banks' profitability. To mitigate the damage from the global financial crisis, macroeconomic policies in advanced economies shifted to expansionary mode in 2009. Since then, banks in advanced economies have operated in an environment of surplus liquidity and low interest rates, which has compressed margins. Despite the unprecedented actions by central banks, global growth remains sluggish and many emerging markets are facing additional pressures from falling commodity prices. This environment has made correspondent banking, which is a low-margin business, less profitable by reducing the interest earned from respondent banks' balances.

18. The post-crisis environment has also made large correspondent banks structurally more risk-averse. Global banks monitor the profitability of their individual business lines and operations, adjusting them based on risk-return considerations. When assessing their risk exposure, banks appear to consider the level of risk associated with each jurisdiction or market in which they operate, the

⁵ The 2014 KPMG survey reported that compliance costs had risen 53 percent between 2011 and 2014, on average. Thirty-six percent of authorities that responded to the World Bank's 2015 survey on correspondent banking identified the inability of or cost for correspondent banks to undertake customer due diligence on respondents' customers as a driver of the loss of CBRs (customer due diligence is used interchangeably with "Know Your Customer") (KPMG 2014a; World Bank 2015a).

⁶ For instance, the U.S. Foreign Account Tax Compliance Act requires foreign financial institutions to report information on accounts of all U.S. citizens, and the Internal Revenue Service uses "John Doe summons" to identify U.S. citizens in offshore financial centers.

specific risk profile of individual customers, and the inherent risk associated with specific business lines and financial products. In their profitability considerations, they also take into account the size of the market, scale of operations, and connectivity. There is pressure to cut costs and deliver greater shareholder returns, which may drive global banks to reconsider certain CBRs.

B. Regulatory Obligations and Enhanced Enforcement

Evolving Risks and Regulatory Requirements

19. Banks are required to comply with economic and trade sanctions, AML/CFT requirements, and anti-bribery and tax evasion regulations applicable in the jurisdiction(s) in which they operate, as well as with those in their home jurisdictions. Compliance with regulatory requirements in these areas involves the implementation of internal controls, including customer due diligence, transaction monitoring, record keeping, and reporting of suspicious transactions. The effective implementation of these procedures may be leading banks to terminate CBRs to comply with targeted financial sanctions, or if there is a reason to believe that the respondent bank is involved in money laundering, terrorist financing, or other fraudulent activities.

20. Complying with an expanding sanctions regime may also be leading banks to reconsider or terminate CBRs. Since the late 1990s, the UN Security Council has been adopting an increasing number of targeted financial sanctions. Sanctions involving targeted asset freezes mostly relate to counter-terrorism and non-proliferation of weapons of mass destruction.⁷ Other objectives include conflict resolution and the protection of civilians and human rights (Security Council Report 2013). UN sanctions establish lists of natural and legal persons, organizations, networks, or regions, whose funds or other assets must be frozen and banks are required to ensure that they are not providing any financial services to those listed. In addition, the use of bilateral economic sanctions as a tool for foreign policy and national security has increased. For example, in the United States, the Office of Foreign Asset Control has authority to prohibit payments and approve licenses to perform limited transactions to sanctioned countries, and designated persons or entities, and the European Union has the authority to impose restrictive measures, including financial sanctions, autonomously in accordance with the principles of Common Foreign and Security Policy.⁸

21. The international approach to AML/CFT has shifted from a mostly rules-based approach to a risk-based approach with the adoption of the 2012 FATF standard.⁹ This risk-based approach is intended to assist in the prioritization and efficient allocation of resources in the long term, by allowing greater flexibility in adopting mitigating measures commensurate with the money laundering and terrorist financing risks identified. In practice, this translates into the implementation of additional preventive measures to mitigate higher risks (for example, enhanced due diligence),

⁷ For example, UN Security Council Resolution 1267 (1999) and successor resolutions provide for targeted sanctions against the Taliban and Al-Qaida and later extended to the Islamic State of Iraq and the Levant (ISIL) as well (2015).

⁸ See European External Action Service, "Sanction Policy" (http://eeas.europa.eu/cfsp/sanctions/index_en.htm).

⁹ Regulated sectors include financial institutions and designated non-financial businesses and professions.

while allowing for simplified preventive measures where the risk is proven to be low.¹⁰ Under the FATF standard, banks are required to conduct ongoing customer due diligence on their respondent banks, which includes gathering sufficient information on the nature of the respondents' business, their reputation and the quality of supervision in the jurisdiction in which they operate, and assess the respondent banks' AML/CFT controls. Customer due diligence should be applied in line with a risk-based approach and enhanced due diligence measures are required with respect to "payable-through accounts" or where higher risks are identified through a risk-based approach.

22. Proper implementation of the risk-based approach may also lead to instances of withdrawal of CBRs. 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 activity, it may 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, corruption) may also call for the termination of CBRs.

23. Several international and bilateral initiatives on tax transparency and AML/CFT may weigh on a bank's risk assessment of its CBRs. Initiatives to "black list" countries for regulatory or supervisory deficiencies or for lack of cooperation have been adopted at a multilateral level, for instance by the FATF¹¹ and the Organisation for Economic Co-operation and Development's Global Forum on Transparency and Exchange of Information for Tax Purposes (the Global Forum).¹² In addition, bilateral initiatives have been introduced in the last decade to increase exchange of tax information and transparency of legal entities, and to fight tax crimes (for example, the U.S. Foreign Account Tax Compliance Act, the EU savings tax directive, and France's blacklist of tax havens). Increasingly, the business model of competition through secrecy and favorable tax regimes is being eroded, pushing banks to exit some jurisdictions (KPMG 2014).

Enforcement Landscape

24. The increasing number of high-profile enforcement actions across the financial services industry may also be a driver of the withdrawal of CBRs. The actions by the United States, and, to

¹⁰ According to the FATF standard, enhanced due diligence measures include (i) obtaining additional information on the customer, intended nature of the business relationship, source of funds, and reasons for intended or performed transaction, (ii) obtaining approval of senior management to commence or continue the business relationship, and (iii) conducting enhanced monitoring (FATF 2012).

¹¹ The FATF issues two public documents three times a year identifying jurisdictions with weak AML/CFT measures. The first document calls for counter-measures to be applied to jurisdictions identified as having serious strategic deficiencies and identifies jurisdictions for which FATF members should apply enhanced due diligence measures proportionate to the risks arising from deficiencies associated with the jurisdiction. The second identifies jurisdictions with strategic AML/CFT weaknesses and encourages FATF members to consider the deficiencies identified.

¹² The Global Forum on Transparency and Exchange of Information for Tax Purposes is the international body for ensuring the implementation of the internationally agreed-upon standards of transparency and exchange of information in the tax area (<http://www.oecd.org/tax/transparency/>). Jurisdictions blacklisted by the Global Forum, through its monitoring and peer review process, may be considered higher risk by financial institutions, particularly in light of the risk of tax evasion.

a lesser extent, those of the EU authorities in imposing penalties to deter misconduct and/or criminal behaviors of banks have raised concerns about the size of potential settlement and fines. In recent times, misconduct fines have risen considerably in the United States and the European Union, with customer due diligence-related fines (for example, for violation of sanctions, AML/CFT, tax obligations) receiving a great deal of attention, but they account for approximately 16 percent of the total misconduct costs (Figure 4). An analysis of the major enforcement actions on customer due diligence-related breaches indicates that they are heavily concentrated in the United States and relate to U.S. sanctions (Box 7). It appears that the number of enforcement actions has recently decreased and that most violations are being resolved with remedial measures undertaken by banks before such violations escalate to enforcement actions to impose monetary penalties.

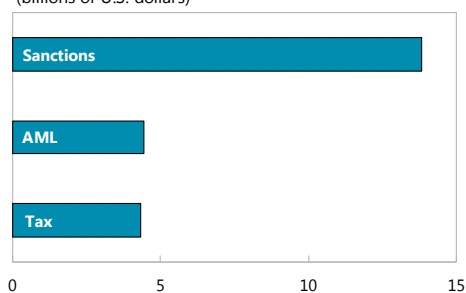
Box 7. Major Enforcement Actions Against Banks Related to Customer Due Diligence

Most large fines for misconduct related to customer due diligence issues have been levied for breach of the U.S. sanctions framework.

A survey of the largest penalties for customer due diligence-related breaches reveals that out of 24 fines of more than US\$ 100 million, all but one originate in the United States. In this category, most penalties involved egregious violations of economic and trade sanctions, with AML-CFT related penalties representing less than 20 percent of the total. The following are some examples of the fines that have been imposed:

- **On economic and trade sanctions violations: BNP Paribas.** In 2014, BNP Paribas pleaded guilty to large-scale violations of U.S. economic sanctions. The bank moved billions of dollars through the U.S. financial system on behalf of Sudanese, Iranian and Cuban entities, which were subject to U.S. sanctions. A U.S. court ordered the bank to pay US\$ 8.9 billion in forfeitures and fines, and sentenced it to a five-year probation during which the bank is required to enhance its compliance policies and procedures.
- **On anti-money laundering: JP Morgan.** In 2014, JP Morgan held the primary bank accounts used in Bernard Madoff's billion-dollar investment fraud. U.S. law enforcement authorities charged the bank with failing to report suspicious transactions related to the accounts used in the scheme. The bank entered into a deferred prosecution agreement and paid US\$ 2.5 billion in civil forfeitures and penalties.
- **On tax evasion: Credit Suisse.** In 2014, Credit Suisse pleaded guilty to assisting U.S. taxpayers in filing false tax returns to evade U.S. income taxes and agreed to pay US\$ 2.6 billion in forfeiture amounts and penalties. The bank had facilitated fund transfers to evade currency transaction reporting requirements and provided offshore cards to clients to repatriate their funds in undeclared accounts.

Breakdown of Fines Paid by Breach
(billions of U.S. dollars)

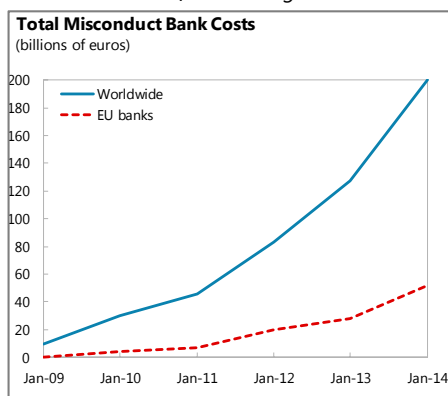


Source: Key Financial Centers Supervisors and Enforcement Agencies; and IMF staff calculations.

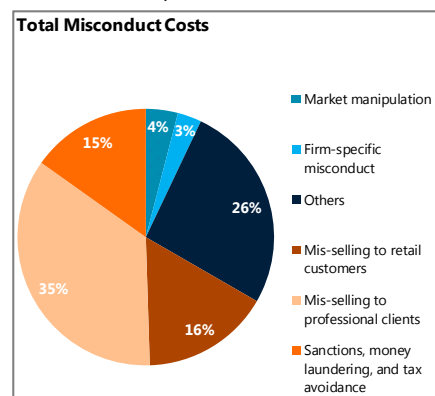
Figure 4. Composition and Trends of Misconduct Costs

Misconduct costs for global banks have increased post-crisis with most of them related to mis-selling and not customer due diligence infractions.

While misconduct fines have grown worldwide,...



...most misconduct fines are related to mis-selling.



Source: European Systemic Risk Board, 2015

25. Regulators in key financial centers have made significant efforts to place information on regulations and enforcement actions into the public domain. Regulators stressed to staff that they never ask financial institutions to terminate specific relationships or business lines or to know their customers' customers in all cases. Instead, they have indicated that their focus is on ensuring that the right systems and risk management processes are in place to support those activities and stressed their preference for those activities to remain inside the regulated system, but with strengthened controls. Comprehensive guidance has been issued, such as the Financial Conduct Authority's Financial Crime Guide in the United Kingdom and the Banking Secrecy Act/AML Examination Manual in the United States. U.S., regulators have noted that they do not expect an outcome of zero violations and have acknowledged the reputational risks for banks. In this context, U.S. authorities have undertaken extensive outreach and education efforts to foreign jurisdictions to explain U.S. regulations and regulatory expectations. Importantly, there appears to be process of escalation from supervisory involvement, to enforcement action, and eventually prosecution and sanction.

26. Despite these efforts, enforcement actions taken have contributed to shaping global banks' perceptions of regulatory expectations, including with regard to CBRs. High-profile enforcement actions in the United States involving global banks have focused on cases where the violations were repeated, systematic, and egregious, representing a fundamental failure of the risk management systems of the banks in question. There has been an increase in the use of Non-Prosecution Agreements,¹³ and Deferred Prosecution Agreements by the U.S. Department of Justice

¹³ Non-Prosecution 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.

in relation to banks' criminal behaviors and of consent orders by U.S. supervisors in relation to breaches of the regulatory framework.¹⁴ These agreements detail voluntary remedial measures taken by banks to address deficiencies and wrongdoings, including to strengthen their internal controls, and in some cases to terminate certain "higher-risk" business relationships, including CBRs.¹⁵ While these agreements are not intended as normative instruments, as the remedial actions are voluntarily agreed to and may go beyond regulatory requirements, 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 sanction regime or the unpredictability of its implementation. Accordingly, these agreements appear to have contributed to shape some banks' perceptions of *de facto* regulatory expectations and have in some cases shaped their approach to maintaining or scaling back CBRs in certain regions or jurisdictions or with certain categories of customers (Artingstall et al, 2016).

Uncertainty about the Regulatory Expectations

27. A lack of clarity on the scope of customer due diligence requirements, including whether there is a need to conduct due diligence on a customer's customer, can lead to a decision to terminate CBRs. This has also been referred to as "Know Your Customer's Customer." In particular, global banks have expressed to staff a range of views on the clarity of U.S. regulatory expectations. While several U.S. and U.K. banks find the compliance expectations to be clear, some European correspondent banks have argued that U.S. regulations are unclear, inconsistently communicated, unevenly implemented by individual examiners, or not well understood, which leads to the banks' decisions to withdraw CBRs. However, what a number of banks appear to be looking for is closer to regulatory certainty (rather than clarity) and perhaps some form of safe harbor. They have also 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.

Conflicting Requirements: Customer Due Diligence and Data Protection and Privacy

28. Conflicting regulatory or legal requirements, notably between customer due diligence and data protection and privacy, can result in the withdrawal of CBRs. 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 in which the correspondent bank has insufficient information on the risk profile of the respondent bank, or if hindrance to information sharing unduly raises its 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

¹⁴ Under Deferred Prosecution 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.

¹⁵ For instance, in the context of its Deferred Prosecution Agreement negotiations, HSBC has exited 109 correspondent relationships for risk reasons and adopted a set of guidelines limiting business in countries that pose high financial crime risk, as part of its voluntary remedial measures (<http://www.hsbc.com/news-and-insight/2012/hsbc-announces-settlements-with-authorities>).

communicating a suspicious transactions 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.

IV. ADDRESSING THE WITHDRAWAL OF CORRESPONDENT BANKING RELATIONSHIPS

29. While the developments associated with CBRs post-crisis are a result of individual decisions of global banks, they may in aggregate lead to a negative externality for financial stability, inclusion, growth and development goals. Against the backdrop of low profitability and rising costs associated with weak macroeconomic conditions, strengthened regulatory standards and enhanced enforcement, it may be rational for an individual bank to cut some CBRs or to increase the price charged for this service based on a cost-benefit analysis. However, simultaneous actions by many banks to withdraw from CBRs would leave only a few global banks providing correspondent banking services in concentrated markets, which could have systemic impact on some affected countries resulting from their being disconnected from the global financial system.

30. Overcoming the coordination and collective action problems associated with the negative externalities that can be created by a continued withdrawal of CBRs justifies concerted measures by public and private sector players. Several initiatives are being considered to help mitigate potential macroeconomic and financial stability impact of the CBR withdrawal. These involve the need to (i) clarify regulatory expectations and address directly legal conflicts and impediments, (ii) strengthen regulation and supervision in line with international standards, including through capacity development, (iii) promote industry initiatives to mitigate compliance costs, and (iv) develop contingency plans to address a risk of complete loss of CBRs in certain jurisdictions. The 2015 FSB action plan is a key element of the coordinated response by international community (FSB 2015).

A. Clarifying Regulatory Expectations

31. Greater outreach and education efforts regarding the application of regulations, particularly by home supervisors of global banks, would help clarify regulatory expectations. Initiatives could include (i) ensuring continued dialogue between regulators and global financial institutions, (ii) promoting proper information flows from home regulators and supervisors towards financial institutions of countries affected, (iii) creating better communication between home regulators and supervisors and those of affected countries, and (iv) technical assistance (TA) from home countries of global banks to the authorities of affected countries (or by correspondent banks to respondent banks).

32. Greater clarity in international standards and domestic regulations could help ensure consistency of regulatory expectations, including with respect to AML/CFT. The FATF standard establishes the minimum requirements in regard to AML/CFT for its members. As with any standard, individual countries can decide to set higher requirements and in line with a risk-based approach,

national regulatory frameworks need to be commensurate with the risk profile and complexity of the countries' banking sectors. Nevertheless, in light of the feedback received from some global banks, particularly those headquartered in Europe, clarification of certain international and domestic requirements, including on the extent of customer due diligence measures required by global banks, could be helpful. In this regard, the FATF has taken steps to clarify the international standards in light of the current phenomenon. To date, the FATF has (i) clarified that “de-risking,” which is viewed as the wholesale termination of relationships without taking into account risk or risk mitigation measures, is not in line with the effective implementation of a risk-based approach to AML/CFT and that such behavior amounts to risk avoidance, (ii) specified that the FATF standard does not require a “Know Your Customers’ Customer” approach as a matter of course, although it may be called for in certain higher-risk situations, and (iii) cautioned that “de-risking” could undermine AML/CFT efforts by driving ML/TF risk to less-regulated sectors or even underground (FATF 2014 a, 2014b). The FATF is expected to publish guidance on CBRs in October 2016, aiming to outline its position more comprehensively.

B. Strengthening and Aligning the Regulatory and Supervisory Frameworks

33. The withdrawal of CBRs can be motivated by a risk assessment in the face of weaknesses in the regulatory and supervisory frameworks of affected jurisdictions. When the withdrawal of CBRs is driven by the perception that a jurisdiction has unacceptable levels of risks (e.g., due to the inability of their own banks to properly conduct customer due diligence), enhancing compliance with international standards—in particular the International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation (FATF Recommendations) and Basel Core Principles for Effective Banking Supervision—should be a key element of its policy response. Political buy-in to adopt necessary reforms, along with sufficient supervisory capacity and resources, is necessary. Increasing exchange of beneficial ownership information and ensuring greater cooperation among national supervisors, including a move toward a greater harmonization of regulatory frameworks and facilitating cross-border information sharing, would help alleviate some concerns.¹⁶ Finally, it is key for offshore financial centers to assess whether they need to change their business models to maintain their relevance in a world in which greater transparency and harmonization of tax and regulatory regimes would diminish incentives for complex corporate structures and tax avoidance (Box 8).

34. Effective regulation and supervision, in line with international standards, is crucial to building trust, reducing risks, and making countries’ markets more attractive to global banks. It helps in identifying and addressing gaps in a bank’s risk management and compliance with international requirements, including those relating to AML/CFT, and in alleviating concerns on the part of a correspondent bank regarding adequacy of controls within a particular respondent bank. Similarly, effective regulation and oversight of Money or Value Transfer Services and Non-Profit

¹⁶ The FATF defines a beneficial owner as “the natural person(s) who ultimately own or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement.”

Organizations, including in regard to AML/CFT, could help them to obtain and maintain access to banking services. For example, in this context, as part of a broader initiative with assistance from the World Bank, the central bank of Somalia recently agreed to delegate on a temporary basis the supervision of Money or Value Transfer Services to a trusted agent that will monitor compliance with AML/CFT standards. Forward-looking risk-based supervision would help financial institutions make risk-return decisions that avoid wholesale CBR withdrawal. Greater cooperation among supervisors is also needed to facilitate cross-border information sharing on customer due diligence.

Box 8. Moving Towards Greater Entity Transparency: Implications for Offshore Jurisdictions

Opaque corporate structures and arrangements can be misused to conceal beneficial ownership and control for illicit purposes, including tax evasion, money laundering and evasion of sanctions. Over the past few years, international initiatives have placed increasing emphasis on entity transparency, including the 2016 London Anti-corruption Summit, the 2014 G-20 High Level Principles on Beneficial Ownership and the 2013 G-8 commitments on transparency of companies and legal arrangements. These initiatives complement the work of the FATF and the Global Forum in the field of entity transparency. Most recently, the documents leaked from the Panamanian law firm Mossack Fonseca highlight the still prevalent use of opaque corporate structures and the need for greater implementation of international initiatives.

The lack of transparency afforded in a particular jurisdiction may affect banks' decision to withdraw CBRs in that jurisdiction. Some of the jurisdictions highlighted in the recently leaked documents as jurisdictions for the incorporation of offshore entities are the same as those having expressed concerns about reduction of their CBRs. The decision to terminate or not enter into a CBR with a financial institution operating in an offshore jurisdiction may be taken based on a reputation of poor compliance with international standards, in particular the AML/CFT standard and the Global Forum, or suspicion of illicit activity, including money laundering, tax evasion and evasion of sanctions.

The sustainability of business models that rely on opaque or offshore structures may therefore have to be reassessed. Although offshore entities can be used for legitimate purposes, deficiencies in the domestic implementation of international standards by the jurisdictions of incorporation can expose them to potential risks of money laundering, tax evasion and evasion of sanctions. In light of increased scrutiny of offshore jurisdictions, illustrated most recently by the media coverage of the leaked documents, these jurisdictions are increasingly exposed to reputational risk. With stronger international standards, notably in regard to AML/CFT and transparency and exchange of tax information, business models that rely on lack of transparency may no longer be sustainable. As others move towards increased transparency, including by adopting public registries of beneficial ownership, offshore jurisdictions are under increased pressure to adopt similar initiatives.

35. Some national authorities are taking action within their jurisdictions, including removing impediments to information sharing. Authorities are putting into place policy responses and mechanisms to overcome challenges related to cross-border sharing of information and data collection, and to strengthen their supervisory and regulatory frameworks. For example, Mexico has been identified as one of the larger economies to be affected by the withdrawal of CBRs and its authorities have stepped up efforts to (i) strengthen the country's AML/CFT framework, (ii) develop a domestic credit transfer system in U.S. dollars, and (iii) facilitate cross-border information sharing with foreign correspondent banks. Mexican authorities have amended their legislation to remove legal

barriers to information sharing between banks arising from the country's banking secrecy and data privacy laws, and are developing a centralized database requiring banks to report all cross-border transactions, while allowing banks to report information on their customers (CPMI 2015a). In Colombia, authorities have been making efforts to migrate from a strict compliance system to a risk-based supervision scheme and are strengthening inter-institutional coordination mechanisms among banks (Box 9).

C. Lowering Compliance Costs through Industry Initiatives

36. Various industry initiatives have been proposed to reduce costs of compliance and risk management and to increase the overall efficiency of CBRs so as to reduce negative externalities (CPMI, 2015a). These include (i) using “Know Your Customer” utilities created by private sector entities with the aim of storing in a single repository relevant customer due diligence information, (ii) promoting the use of the Legal Entity Identifier for all banks involved in correspondent banking,¹⁷ (iii) reviewing the format of payment messages to ensure that they meet the needs of clients, the financial industry, and law enforcement in a cost-effective way, and (iv) further facilitating enhanced due diligence by promoting the use of the Legal Entity Identifier for identifying corporate customers, including provisions on information sharing with correspondent banks into the contracts with cross-border payment services customers and developing centralized databases—building on the Mexican experience—on the identities, business, and transactions of banks' customers active in cross-border payment services.

37. Market-based solutions, such as bundling of banking products and risk-based pricing, may help in some cases. For some respondent banks, compliance costs relating to customer due diligence may be too high to undertake CBRs. One potential solution would be to bundle other banking services (for example, credit card clearing, letters of credit, and fixed-income and wealth management operations) with CBRs. This would allow the use of the same robust compliance system to reduce the fixed cost of compliance over a larger scale of banking services. For correspondent banks, differentiating and increasing pricing of CBRs across different countries and respondent banks, which has been attempted in The Bahamas, may help address the lack of profitability stemming from low volumes of transactions or increased compliance costs. The respondent bank could then pass on these higher costs for maintenance of CBRs to its customers. Improving internal systems to pro-rate compliance costs across customers could also help banks to better price their services and risks.

38. Innovative money transfer start-ups have entered the remittances market in recent years offering lower cost alternatives to traditional Money or Value Transfer Services. By offering an alternative to banks, they can enable customers to transfer money more easily, including through the use of virtual currencies and the blockchain distributed ledger technology, for international payments (CPMI 2015b; He et al. 2016). While the growing presence of non-banks in payment systems is increasing competition and could partially address the reduction in CBRs, it also raises potential issues associated with operational and money laundering or terrorist financing risks,

¹⁷ The Legal Entity Identifier is a 20-character alpha-numeric code used to uniquely identify legally distinct entities that engage in financial transactions and is issued by Local Operating Units of the Global Legal Entity Identifier System (<http://www.lei.org/lei.htm>).

leveling the playing field, consumer protection and outsourcing. In particular, to be viable, such alternatives need to address financial integrity issues related to their anonymity and cross-border reach to mitigate the risk migration.

Box 9. National Authorities' Efforts in Addressing the Withdrawal of Correspondent Banking Relationships

Colombia

Colombia has put in place a comprehensive risk based supervision scheme of AML/CFT for financial institutions. The original mid-1990's system of prevention of money laundering has evolved into a more comprehensive risk based system that engages all entities under the surveillance of the Superfinanciera to design and implement a Risk Management System permitting the adequate identification, measurement, control and monitoring of risk related to money laundering and terrorism financing. Current regulatory projects intend to improve compliance, as well as to deepen, strengthen and consolidate the legal framework for the prevention and control of money laundering and terrorism financing. The current Colombian legal system has served as a reference for other countries (for example, Costa Rica, Ecuador, Guatemala, and Honduras).

Colombia continues to develop domestic inter-agency coordination. To further strengthen AML/CFT supervision, the Commission for the Coordination of Inter-institutional Control of Money Laundering is encouraging all competent authorities to design or enhance memorandums of understanding to share relevant information and facilitate task coordination among national authorities, such as the Ministry of Justice and Law, the Attorney General's Office, the Ministry of Foreign Affairs, and international organizations. In this regard, Colombia has been supported by the U.S. government, including through agencies such as the Department of Justice, the Federal Bureau of Investigation and the Office of Foreign Asset Control.

Discussions with the Colombian authorities have indicated that large scale reduction of CBRs has not occurred, even though the country has historically been associated with money laundering and terrorism and financing concerns. Dialogue with large domestic banks has revealed no significant reduction in trade finance, remittances, or U.S. dollar wire transfers and these banks have not reported a lack of liquidity lines for working capital purposes. While smaller financial intermediaries have indicated that their CBRs have been adversely affected, especially in cases in which a global bank was the counterpart, they had found alternatives with other smaller and medium-sized correspondent banks. This, however, appears to have increased the cost of establishing new CBRs. When there was a perception of higher risks among these smaller financial intermediaries because of their business ties to Venezuela, these operations were closed.

Mexico

The Mexican authorities have taken steps to strengthen the country's AML/CFT regulatory and supervisory frameworks. To promote an active policy on AML/CFT among its institutions, Mexico has issued regulations to increase AML/CFT controls particularly for institutions involved in high risk activities. The authorities have implemented AML/CFT monitoring systems and processes for the country's real time gross settlement payment system, and they encourage institutions to do the same in regard to their interactions with the system. The Central Bank of Mexico has issued regulations requiring the use of the Legal Entity Identifier standard for banks and large firms involved in conducting certain transactions, and the authorities are conducting enhanced supervision of non-bank financial institutions.

The central bank is also considering making mandatory the use of certain message types and message fields in payment system messages to enable enhanced data collection and analysis of cross border transactions. This aims to address the issue that banks are often not using the most suitable payment message type. By defining certain message types and message fields as mandatory for completion by banks, the central bank expects that data collection will be enhanced, including on the ordering and beneficiary clients, helping conduct in-depth analysis of cross border transactions.

Mexico has also adopted regulations to facilitate cross-border information sharing between domestic banks and foreign correspondent banks. In situations in which a correspondent bank lacks sufficient information to satisfy itself of the risk profile of the respondent bank, or those in which hindrance to information sharing unduly raises its costs, it may choose to terminate (or not to enter into) a CBR. Recognizing this, Mexico has 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 addition, Mexican authorities are in the early stages of developing a centralized database for information sharing, which is expected to serve as repository for aggregated information on cross-border transactions, including on the originators of the transactions. Domestic and foreign authorities would be able to check the database for transactional information, including to conduct enhanced due diligence in regard to certain customers.

The Central Bank of Mexico has also developed and operates a domestic U.S. dollar credit transfer payment system. Its objective is to process transfers in U.S. dollar accounts between domestic banks for firms established in Mexico. Firms and banks participating in this system are subject to strict AML/CFT controls.

The Bahamas

Authorities in The Bahamas are addressing challenges from the loss of CBRs in a number of ways. In addition to strengthening risk-based supervision and improving transparency (for example, reporting under the U.S. Foreign Account Tax Compliance Act commenced in September 2015), they have taken steps to address risks from loss of CBRs. In 2015 the country's central bank introduced amendments to the central bank's AML/CFT Guidelines and new Wire Transfer Regulations. The authorities are also actively participating in regional bodies aiming to create collective solutions to loss of CBRs.

The West Bank and Gaza

The Palestinian authorities have adopted a multi-pronged approach to addressing the risk of a further reduction in CBRs. Since 2008 the Palestine Monetary Authority has worked to ensure a rigorous banking supervision environment and to expand its macroprudential toolkit so that banks can be well positioned to cope with shocks. In light of recent emerging strains in CBRs, the West Bank and Gaza is taking targeted steps to strengthen the AML/CFT elements of the domestic regulatory framework. In late 2015, the West Bank and Gaza became a member of MENAFATF, a FATF-style regional body for the Middle East and North Africa region. The authorities also approved a new AML/CFT law in December 2015, and the accompanying regulation that criminalizes terror financing establishes a committee to order the freezing of terrorist assets and issue a list of designated entities. To further reassure foreign players, the Palestinian authorities have requested IMF TA to support the implementation of the new law and strengthen the CFT framework. They have also commissioned a soon-to-be completed assessment of the West Bank and Gaza's AML/CFT regime by an internationally recognized firm to help demonstrate adherence to international best practice.

Source: IMF country desks.

39. However, the market is still dominated by traditional money transfer systems and start-ups need to be subject to prudential regulations. Most start-ups rely on existing banking infrastructure for transfers or settlement. For example, the largest traditional money transfer company accounted for 13 percent of remittance flows in 2014. Despite its growth, the largest money transfer start-up accounted for less than 2 percent of global remittances. Its business model hinges on building a large network of customers to create opportunities for matching transactions, which will

take time. In addition, these starts-up need to be subjected to prudential regulations in order to mitigate operational and market risks.

40. Effective oversight frameworks for new payment methods need to be developed to safeguard public confidence and financial stability. 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 (Bank for International Settlement and World Bank 2015; Khiaonarong 2014).

41. The Legal Entity Identifier approach may help financial institutions manage ML/TF risks through enhanced screening, customer due diligence improvements and implementation of FATF standards. “Know Your Customer” utilities and information-sharing mechanisms require unambiguous identification of the banks or customers included in the respective databases. The Legal Entity Identifier can be promoted as an efficient global standard for these utilities without the need for a separate standard. Such an approach can also help financial institutions identify specific entities unambiguously and increase the effectiveness of automatic screening packages, particularly for identifying sanctioned entities. Finally, it may become an option for supporting the implementation of specific FATF recommendations (for example, on the provision of originator and beneficiary information in payment messages). However, the feasibility of this approach remains to be tested.

D. The Case for Contingency Planning and Public Support

42. While the initiatives above could help alleviate impact from withdrawal of CBRs over the medium and long term, contingency planning and short-term responses may be needed for a few countries facing severe loss of correspondent banking services. Indeed, in some countries only a few CBR providers remain, and even central banks are reported to face difficulties maintaining CBRs in certain jurisdictions (for example, Belize). In this context, contingency plans should be developed by authorities in the affected countries to mitigate the risk of a major disruption to cross-border financial flows. These plans should include (i) enhanced communication with home authorities and global banks to understand the nature of their risk management concerns, (ii) developing thorough understanding of domestic financial systems’ linkages with correspondent banks and alternative payment arrangements, which could involve non-banks in retail payments and the provision of cross payment services (CPMI 2014), (iii) mapping the necessary legal and regulatory changes to facilitate compliance with relevant international standards, and (iv) carefully assessing the benefits, costs, and risks of developing or using public entities or centralized payment systems to address a complete loss of CBRs.

43. The role of public entities in addressing the loss of CBRs merits careful consideration. Possible mechanisms can build on existing experiences in New Zealand, the United Kingdom, and the United States (Box 10). Further, some jurisdictions in the Caribbean are considering the feasibility of setting up regional arrangements to process international transactions, with the costs being shared by banks using the facility or subsidized by a regional financial arrangement or regional fund (Boyce 2016). Mexico has established a domestic payment system for U.S. dollar transfers and uses the central bank’s correspondent banks in the United States to facilitate fund transfers. Some central

banks located in jurisdictions affected by the phenomenon have also considered the feasibility of a temporary mechanism with foreign central banks in globally systemic countries to settle low risk transactions. Another alternative that is being discussed is to set up a publicly-backed vehicle to provide clearing services to those banks that are finding it difficult to secure CBRs and that are willing to improve compliance with AML/CFT standards.

44. 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 jurisdictions from acting as counterparty in commercial transactions need to be addressed, while authorities must ensure that such mechanisms meet all relevant regulatory standards and applicable AML/CFT obligations. Indeed, if concerns about the integrity of the underlying transactions and compliance with AML/CFT standards remain, a public entity attempting to carry out bundled transactions on behalf of Money or Value Transfer Services may face the same challenges that banks face, and a central bank could risk its own CBRs if it attempts to carry out transactions that global banks have already categorized as high risk.

Box 10. Addressing Compliance Issues in International Remittances

The experiences of the U.S. Federal Reserve, the U.K. government, and banks in New Zealand shed light on possible areas to address regulatory compliance associated with cross-border payments.

United States Central Bank Automated Clearing House Cross-Border Payment Services

The Federal Reserve of Atlanta (FRBA) has enabled financial institutions to transfer funds through the FedGlobal Automated Clearing House. International remittances are channeled through the U.S. domestic payment system linked to foreign financial institutions and regulated Money or Value Transfer Services in receiving countries. Such transfers are on behalf of their account holders to unbanked receivers in 11 Central and South American countries and banked receivers in 25 other countries and include sending and receiving domestic and international Automated Clearing House credit and debit items. Each FedGlobal agreement between the FRBA and processors and foreign gateway operators needs to comply with all relevant regulatory requirements and procedures, including AML/CFT. The FRBA acts as the U.S. Gateway Operator for FedGlobal Automated Clearing House payments, monitors the payments processed by FedGlobal, and maintains a compliance officer and compliance program.

The New Zealand-Pacific Remittance Project

Under the leadership of the Reserve Bank of New Zealand and support of authorities from the Pacific Island countries, New Zealand-based banks have created special remittance card accounts for remitters. The initiative was launched in 2007 and enables low-cost remittances through the banking system's international Automated Teller Machine and Electronic Funds Transfer at Point of Sale networks. The facility includes daily monitoring to mitigate financial integrity risks. Enabling the use of the card required changes to the AML/CFT legislation in New Zealand, and the implementation of the Financial Transactions Reporting (Interpretations) Regulation. The initiative helped to bring down the cost of sending remittances from 15–25 percent to about 7 percent of the value of the remittance transaction.

The United Kingdom and Somalia: Safer Corridor Pilot

Following the shutdown in 2013 of accounts of Somali Money or Value Transfer Services by the only U.K. bank operating in Somalia, the U.K. government set up a Somali-U.K. Safer Corridor Pilot to be mobilized in the event of a significant disruption in remittances. Its main idea was to create a more transparent and safer system for the Somali community's remittances by addressing banks' AML/CFT compliance concerns, helping to provide assurance to banks that the risks can be managed effectively and supporting the Somali authorities to build a regulated financial sector. The U.K. government funded the project, including an assessment of technical solutions such as biometrics, and the World Bank was responsible for its design and implementation. The need to mobilize the pilot eventually did not materialize as remittances have continued to flow. Nonetheless, several milestones were achieved. The authorities have committed to strengthen banking supervision and regulation, issued AML/CFT legislation, and established a financial intelligence unit.

Sources: FedGlobal ACH Payments Service Origination Manual; Abel and Hailwood, 2012; Hassan and Liberatore, 2016.

V. THE ROLE OF THE IMF

45. IMF staff has been supporting member countries in addressing issues arising from the withdrawal of CBRs, with a view to promoting financial inclusion and ensuring financial stability. The issue of withdrawal of CBR has been discussed in the context of bilateral surveillance when deemed macro-critical for a country. As withdrawal of CBRs is not, at this time, considered to significantly affect the effective operation of the international monetary system, it has not been considered in the Fund's multilateral surveillance. However, this issue was discussed at the time of Article IV consultations with some countries that are home to global banks.¹⁸ The issue has been discussed in the context of the Financial Sector Assessment (FSAP) Program when relevant for financial stability. Through these discussions, together with TA and analytical work, IMF staff has been monitoring the impact of the withdrawal of CBRs, fostering a shared understanding of the complexity of this phenomenon and helping develop possible policy responses. This SDN is another step in this direction.

46. The IMF has facilitated an international dialogue to foster shared understanding of the complexity of issues related to the withdrawal of CBRs and develop possible policy responses. It has collaborated with the FSB, World Bank, G20, FATF, Arab Monetary Fund, Union of Arab Banks, CPMI, and Caribbean Task Force, among others, to analyze the scale, drivers, and impact of the withdrawal of CBRs through various surveys and regional roundtables. This coordination has helped identify member countries, financial institutions and financial products and services that have been most affected by this phenomenon. This approach has also ensured that each institution brings its own expertise, perspective and engagement with countries' authorities, while developing a consistent and globally coordinated approach to address this phenomenon.

47. Continued data-gathering efforts remain necessary to enhance our 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, which is critical to such analysis. IMF staff continues to gather quantitative and qualitative evidence on instances of CBR withdrawal and the magnitude of the impact through Article IV consultations and the FSAP, where relevant.

48. The IMF has also been working extensively with its member countries to assess the effectiveness of their supervisory and regulatory frameworks. The establishment of the FSAP in 1999 has been instrumental in undertaking these assessments, both for the Basel Core Principles and FATF standards. In conducting the FSAPs, the IMF, 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, thereby lessening the frequency and intensity of financial system issues. Between 2012 and mid-2016, 87 FSAPs were completed across all regions among the IMF's membership. Many of these FSAPs identified shortcomings in the areas of banking supervision and

¹⁸ <https://www.imf.org/external/np/exr/facts/isd.htm>.

AML/CFT and called for strengthening frameworks to prevent banks from being used for criminal activities.

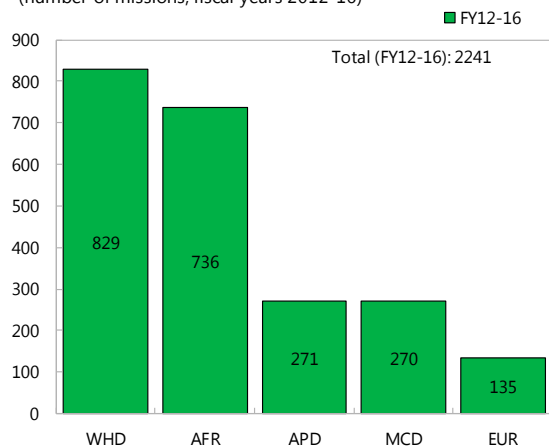
49. Building on the FSAP and surveillance findings, the IMF TA program helps countries strengthen regulatory and supervisory frameworks, including with respect to AML/CFT (Figure 5). This assistance is particularly important for those countries in which lack of capacity hinders efforts to strengthen the frameworks and is closely coordinated with relevant public and private stakeholders, including the World Bank, multilateral development banks, and donor countries. Among other things, this TA could be helpful in addressing customer due diligence issues and in improving the effectiveness of AML supervision. The IMF, together with the World Bank, also contributes to the peer evaluation process of the FATF and its regional bodies for assessing and promoting members' compliance with the FATF recommendations. Full engagement by national authorities is a precondition for success, helping limit the loss of CBRs.

Figure 5. Technical Assistance to Strengthen Supervision, Regulation, and AML/CFT

The IMF TA to help members implement AML/CFT standards has been more uniform across all regions than TA to strengthen supervision and regulation.

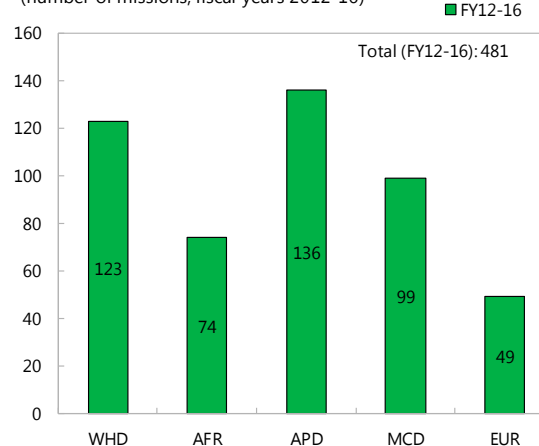
TA to strengthen supervision and regulation has been focused more in the Americas, Caribbean, and Africa...

TA on banking supervision and regulation
(number of missions, fiscal years 2012-16)



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

AML/CFT TA
(number of missions, fiscal years 2012-16)



Source: IMF staff estimates.

Note: AFR = sub-Saharan Africa; APD = Asian and the Pacific; EUR = Europe; MCD = Middle East and Central Asia; WHD = Western Hemisphere.

VI. THE WAY FORWARD

50. Collective and coordinated efforts by public and private sector stakeholders are called for to ensure continued access to financial services. Policy responses to CBR withdrawal need to

be tailored to the specific circumstances of a country or a region, and take into account the complexity of the CBR withdrawal. They could include the following:

- Continued effort to build understanding of the causes and implications of this phenomenon. To that end, it is key to go beyond surveys. Authorities need to reach out directly to financial services providers to further improve their data collection to better understand this phenomenon.
- Further clarification of, or outreach on, international standards (including by the FATF) and national regulators' expectations. This would assist in leveling the playing field, thus reducing the risk of precautionary behavior or strategies.
- Facilitating cross-border information sharing and data collection by removing domestic legal barriers from countries' banking secrecy and data privacy laws. This would allow banks to conduct effective customer due diligence on their correspondent counterparts. In some instances, improving identity verification systems within a country may be warranted.
- Continued engagement by the various public and private TA providers to help build capacity in the affected countries. This TA should aim at strengthening the regulatory and supervisory framework in line with international standards, including those for AML/CFT.
- Promoting shared industry measures that could help lower the cost of compliance. In this context, accelerating the use of the Legal Entity Identifier for all banks involved in correspondent banking as a means of improving identification could be considered. Further improvements in payment message format may be also be helpful. Innovative approaches to payments could provide further options to reduce compliance costs. In addition, market-based solutions such as bundling of banking products and risk-based pricing may help some countries avoid a withdrawal of CBR.
- Reassessment, in some cases, of the sustainability of certain business models that rely on opaque or offshore structures. Countries hosting offshore financial centers are increasingly exposed to reputational risks. Related costs, including the loss of CBRs, may outweigh the benefits of maintaining these business models.
- Finally, if a complete loss of CBRs is imminent, the role of public support needs to be carefully considered. As an initial step, this could involve political engagement at the highest level to establish a dialogue between authorities and the private sector on the impact and remedial measures. Use of publicly-backed vehicles or direct involvement of central banks may help limit major disruptions. However, such intervention should be subject to proper risk assessment to ensure that it (i) is permissible under the central bank's law or other relevant legislation and regulations, (ii) is operationally feasible, and (iii) avoids creating significant additional market, credit, and other risks to the central bank. In addition, to the extent that the central bank is performing a function regulated by the AML/CFT regime, this function must be conducted in line with applicable AML/CFT obligations.

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