



FINANCE, COMPETITIVENESS & INNOVATION INSIGHT | STABILITY AND INTEGRITY

The Decline in Access to Correspondent Banking Services in Emerging Markets: Trends, Impacts, and Solutions

Lessons Learned from Eight Country Case Studies

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ACRONYMS AND ABBREVIATIONS

AUD	Australian dollar
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
BBA	British Bankers Association
BdM	Banco de Mexico
BIS	Bank for International Settlements
CBR	correspondent banking relationship
CBS	Central Bank of Somalia
CDD	customer due diligence
CFG	Charity Finance Group
CNY	Chinese yuan
CPMI	Committee on Payments and Market Infrastructures
DFID	Department for International Development
EAP	East Asia and Pacific
EU	European Union
EUR	euro
FATF	Financial Action Task Force
Fintech	financial technology
FSB	Financial Stability Board
GDP	gross domestic product
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IMF	International Monetary Fund
ISO	International Organization for Standardization
JPY	Japanese yen
KYC	know your customer
KYCC	know your customer's customer
KYCCC	know your customer's customers' customer
LAC	Latin America and the Caribbean
MAS	Monetary Authority of Singapore
ML/FT	money laundering/financing of terrorism

MTOs	money transfer operators
NGO	nongovernmental organizations
NPO	nonprofit organizations
NZD	New Zealand dollars
OECD	Organisation for Economic Co-operation and Development
RBA	risk-based approach
RMA	relation management application
RSP	remittance service provider
SA	South Asia
SME	small- and medium-scale enterprise
SSA	Sub-Saharan Africa
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TDB	Tonga Development Bank
UAE	United Arab Emirates
USD	United States dollar
WBG	World Bank Group

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This paper summarizes the main outcomes of eight country case studies carried out from April to November 2017. Each visit led to the production of an aide-memoire for the authorities. Because of confidentiality restrictions, the country cases did not lead to a specific publication, and therefore the results have been made anonymous in the present report.



EXECUTIVE SUMMARY

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

Since the global financial crisis of 2008, global banks have been reviewing their CBRs and many have decided to terminate or limit their correspondent banking services (also known as *derisking*) to different regions, jurisdictions, or categories of clients. That process is still taking place, and all countries in this survey reported cases of derisking. This response is true for both local respondent banks and money transfer operators (MTOs). But, as this study confirms, the effects differ significantly from institution to institution and from country to country. In small islands states, the impact of the decline in CBRs has been acute. While those involved in the global debate tacitly assume that large banks have left regions or countries altogether, our study shows that, in fact, the process is more selective. Global banks have derisked certain banks, but they have also oriented and trained others in the same countries, suggesting that their decisions to terminate a relationship were not exclusively motivated by jurisdictional concerns.

In some cases, derisking is justified. Although the loss of critical financial services in a country is a cause for concern and may require authorities' intervention to protect the interest of those affected, there are instances when a global bank is justified in terminating certain relationships. A case in point is the derisking of a prominent respondent bank by all its foreign correspondents following the dismissal

of the top management team for money laundering and corruption offenses.

Overall, in the eight countries covered in this study, the macroeconomic impact of derisking appears limited. In a few countries, the net loss of CBRs has been marginal, and the impact has remained contained. Banks have been able to cope with the situation by dealing with fewer correspondent banks or establishing new ones, but this process can be cumbersome. In addition, in many cases the terms and conditions of newly established CBRs were significantly more unfavorable than under previous relationships, which confirms findings from the 2015 World Bank survey on correspondent banking.¹

While more robust vigilance of correspondent banking channels is encouraged, maintaining CBRs comes at a cost to both correspondent and respondent banks. Rising compliance costs associated with more stringent Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regulations and international sanctions regimes makes the provision of correspondent banking services a less financially attractive business proposition. All bankers interviewed for this study acknowledged that correspondent accounts, including the new ones, cost much more to maintain, thus requiring larger transactions volume and fees to remain a viable activity.

The study shows that the effect of derisking has been felt at the microlevel, sometimes intensively.

On a few rare occasions, banks nearly lost their access to the international financial system. Impacts for banks include, among other things, (a) the loss of significant numbers of customers, mostly corporate companies and exporters; (b) a significant drop in remittance volumes; (c) the loss of highly profitable businesses, such as the supply of the United States dollar (USD) to certain countries; and (d) adverse effects on banks' ratings.

However, the effect on banks' customers is currently limited for costs, despite a few exceptions.

The increase in costs generated by higher due diligence related to AML/CFT regulations is rarely passed on to banks' clients and is typically absorbed by the banks or money transfer operators (MTOs). There are cases, though, where clients have been affected significantly. In one country, for example, a bank indicated that its costs per transaction in switching CBRs had risen from USD 9 to USD 50–60.

MTOs have been particularly affected by derisking because of their cash-intensive business.

In almost all surveyed countries, a number of respondent banks received instructions from their correspondent banks not to service MTOs anymore, and financial services provided by MTOs are precisely the type of cross-border financial services intensively used in less financially developed countries. MTOs' accounts were closed, and this action has disrupted the operations of many operators.

Foreign exchange traders, another cash-intensive business, have also been significantly affected.

In one country for example, at the end of 2014, 80 percent of foreign exchange traders had foreign currency accounts with local banks; by 2017, this number had dropped to 51 percent.

Although cash-intensive businesses have found alternatives, these expose MTOs to higher risks and uncertainty.

To remain in business, some businesses have resorted to unconventional methods

such as the use of personal bank accounts to channel money or the use of commercial couriers to carry cash between sending and receiving countries. In the long term, these alternatives are not sustainable or desirable.

The direct effect of derisking on remittances, for the cost of making remittances and enabling inflows, is still unclear.

While some countries in which remittance companies have lost accounts experienced an increase of their average cost of making remittances in the past year, others have seen a decrease. Additionally, four of the eight visited countries have experienced a decrease in the volume of remittance inflows in the past five years, while the other four have shown a steady increase year after year. Therefore, the overall picture is decidedly mixed, and further analysis is needed to understand the different underlying factors (such as geopolitical risks and oil prices) that may affect costs and inflows. In this regard, the work currently being undertaken by the Financial Stability Board on remittances is very timely and opportune.

Derisking has also had cross-border spillover effects, especially in the Southern African Development Community.

Pan-African banks have been under pressure from their correspondents to stop doing certain business (for example, supplying foreign currencies) in neighboring countries to maintain their CBRs. Consequently, USD clearing has been terminated or restricted in several countries, which in turn further weakens local economies.

Even though the study did not find any macroeconomic effects in any of the eight visited countries, the existence of significant microeffects and business distortions warrants further attention.

First, there is a trend toward a concentration of correspondent banking services with fewer institutions handling larger volumes, leading to the buildup of counterparty risks. Second, the concentration of MTOs and remittances flows in a limited number of banks raises the prospect of systemic risks in a few jurisdictions. Third, in some cases, local respondent banks sought recourse

with second tier and less reputable institutions after global banks terminated their CBRs. This shift warrants close scrutiny from domestic authorities. Last but not least, there are concerns that derisking has resulted in the creation of new, informal channels through which money is now flowing. Circumstantial evidence suggests that informality and greater use of cash and other unconventional channels have resurged in a few places as a possible consequence of derisking. If pervasive, they could undermine AML/CFT objectives by driving financial transactions outside of regulated channels.

To address these situations, there are several avenues that can be explored at both the industry and country levels. This paper suggests a few ideas intended to assist countries' authorities and market players in managing problems arising from the withdrawal of correspondent banking services. To be clear, these ideas are relevant to the countries included in the study, but not necessarily for other countries. These ideas include the following:

- Gathering data on CBR closures and on the industries and types of activities affected by derisking, at the country level

- Encouraging at-risk respondent banks to include the issue of derisking in their own contingency planning as part of the prudential requirements and supervisory practices
- Establishing or maintaining open channels of communication between correspondent and respondent banks (A lack of awareness of country context is often a contributing factor to derisking, and sharing mutual concerns is valuable intelligence to the correspondent bank industry.)
- Improving regulatory oversight of the obligations of MTOs toward AML/CFT and generally strengthening the AML/CFT regime by ensuring that resources are allocated and used according to risk
- Liaising with industry and financial technology (Fintech) actors to discuss solutions to derisking. Properly regulated, Fintech has a great potential for lowering the cost of compliance, reducing the use of cash, and improving transaction monitoring, which in turn can provide confidence to correspondent banks.





I. INTRODUCTION

The Wolfsberg group of banks, which developed the Wolfsberg Principles for Correspondent Banking as recommended best practice for establishing and maintaining correspondent accounts, defines correspondent banking as “the provision of a current or other liability account, and related services, to another financial institution, including affiliates, used for the execution of third party payments and trade finance, as well as its own cash clearing, liquidity management and short-term borrowing or investment needs in a particular currency.”²

Correspondent banking is an essential component of the global payments system, especially for cross-border transactions. Through correspondent banking relationships, respondent banks can access financial services in different jurisdictions and provide cross-border payment services to their customers, supporting, among other things, international trade and remittances and thus financial inclusion. In addition, most of the payment solutions that do not involve a bank account at customer level (for example, remittances), rely on correspondent banking for the actual transfer of funds.

The termination of correspondent banking services has the potential to reverse some of the progress made in reducing remittance prices and fees,³ as well as in the prices of other financial instruments and services. Therefore, the World Bank Group (WBG), at the request of the G20 and with the support of the Financial Stability Board (FSB) and the Committee on Payments and Market Infrastructures (CPMI), carried out two fact-finding projects on derisking.⁴ The projects confirmed the trend that correspondent banking relationships had been restricted or terminated, affecting especially MTOs, small and medium domestic banks, and small and medium exporters.

In the conclusion of these surveys, the WBG noted that, going forward, it would “seek to provide more insight into the further effects on financial inclusion and economic activity resulting from the withdrawal of CBRs.” In the same vein, the FSB action plan

presented to the G20 Leaders in November 2015 to address the decline in correspondent banking stated that “the FSB would encourage the collection of relevant information by the World Bank and other organisations on the scale of withdrawal, its causes and effects.”⁵ Furthermore, during a subsequent stakeholder dialogue between relevant parties organized by the World Bank and the Association of Certified Anti-Money Laundering Specialists, it was recommended that “further work should be undertaken to identify and quantify the negative effects on the economies of smaller jurisdictions (trade finance and remittance dependent individuals/families) to strengthen the case for public intervention/concern.”⁶

The present paper aims to answer this call for more information to better understand the effects of derisking at the local level, considering local banks, MTOs, and the final customers receiving remittances, using trade finance and benefiting from other services. In addition, the objective of this work is to inform policy decisions of national authorities and the international community, including standard-setting bodies. In this sense, the work includes a review of existing policy responses and technical solutions, as well as WBG policy recommendations.

The findings of these case studies complement the efforts carried out since 2015 by other entities that confirm and explain the consequences of derisking. In 2015 and 2016, the CPMI, the International

Monetary Fund (IMF), and the Commonwealth and the Charity Finance Group (CFG) with the U.K. Department for International Development (DFID) and British Bankers Association (BBA) prepared individual country reports.⁷ These highlighted the concentration of flows, the complex and diverse reasons for derisking, the critical impact of derisking in some countries, the increase in the use of underground financial services, and the difficulties that charities were facing to send vital funds to conflict and at-risk locations.

More recently, in 2017, the FSB, the IMF, and the International Finance Corporation (IFC) published further work on the matter. The FSB report contains evidence from an FSB survey of more than 300 banks in nearly 50 jurisdictions, plus data from the global payment messaging system SWIFT (Society for Worldwide Interbank Financial Telecommunication).⁸ It shows that the decline in the number of correspondent banking relationships is continuing across all regions, but to a varying degree and more pronounced for USD and euro transactions. The latest IMF report

highlights that the factors leading to global banks' withdrawal of CBRs are multiple, interrelated, and vary case-by-case and that addressing the withdrawal of CBRs will take time and require strengthened, coordinated, and collective action on the part of public and private stakeholders.⁹ The IFC carried out another survey focused on banks in emerging markets, which covered more than 300 banking clients in 92 countries.¹⁰ The results of the survey show that 72 percent of participant banks are facing multiple external challenges that reduce their ability to serve customers, mainly caused by compliance costs and correspondent banking-related difficulties. In addition, it highlights that banks are reducing benefits to their customers (or cutting customers), raising fees, and reducing credit limits.

This paper offers further insights into the debate through the prism of eight emerging market economies in East Asia and Pacific (EAP), Latin America and the Caribbean (LAC), South Asia (SA), and Sub-Saharan Africa (SSA).

II. METHODOLOGY AND SCOPE

The countries in this study were selected on the basis of several criteria, including (a) concerns about the scale of derisking in a given country, as evidenced by public statements or responses to surveys on derisking, and (b) the impact on remittances activities, including on the cost of operations and the search and use of innovative technical solutions to address the derisking problem. On that basis, seven emerging market economies were selected to analyze the effects of derisking, and another jurisdiction was chosen for its approach to solving the derisking problem. The survey covers countries from all the regions with the exception of Eastern Europe and Central Asia and the Middle East and North Africa. The sample was not based on objective criteria only but also on practical factors such as the countries' interest in supporting this study or their reluctance to share detailed information. Participating countries often cited confidentiality concerns, and thus the authors decided not to mention any country in this study—with a few exceptions.¹¹

Each of the selected countries was visited by a team of WBG experts who spoke with the authorities, including ministries of finance and financial sector regulatory bodies; national and international banks; MTOs, including some operating in the mobile payment space; and, where relevant, chambers of commerce and financial inclusion committees. Overall, the team spoke to multiple financial institutions that constituted a representative sample of the banking sector and met with the most relevant MTOs in each jurisdiction.

Before the visit, the WBG sent questionnaires to collect both qualitative and quantitative data that would inform the discussions. The questionnaires sought data on the following: (a) the number of CBRs terminated or restricted and those still operational for each bank, (b) the types of clients requiring correspondent banking channels and on those whose funds the correspondent did not wish to deal with, (c) the degree of concentration of MTO activities in a number of local respondent banks, (d) the degree of dependence of the respondents on foreign correspondent banks, and (e) the reasons for closing accounts or ending correspondent

relationships. The data were supplemented by qualitative information gathered through anecdotal stories and testimonies during an onsite visit.

In this work, the WBG considered many facets of derisking, including (a) increased costs, (b) limitations of business opportunities, (c) concentration of risks, (d) resurgence of informality, and (e) thoroughness of AML/CFT practices and risk management processes.

The report is more than only a reflection of the eight country visits. Field work was supplemented by conference calls with third countries that were not surveyed but whose authorities expressed interest in sharing their experience of derisking. In addition, roundtables and forums organized during the 2017 WBG and IMF Annual Meeting in Washington, DC, were an opportunity to collect further information on the effects of derisking in emerging markets.

To be clear, the effects of derisking are diverse and measured in different ways by different countries. That is partly because derisking is a new area of inquiry and no internationally agreed standards and

metrics have been developed yet. The proposed fact gathering put forward by the IMF may, over time, establish such metrics, comparable country by country.¹² For the time being, the effects are measured in different ways, and therefore it is noted that there is significant heterogeneity in the derisking effects analyzed in this paper. The

conclusions that follow are not necessarily valid globally; they apply only to the countries discussed. Of course, they may be useful to other countries in similar situations—but the aim is not to provide a global picture of the state of derisking, but a picture at the local level.

III. MAIN OUTCOMES OF THE COUNTRY CASE STUDIES

3.1 The termination or restriction of CBRs in the banking sector

General trends in the banking sector

All countries in this survey reported cases of CBR terminations. In all countries surveyed, banks' CBRs were terminated or restricted. In one country, 9 of an initial 42 correspondents cut off or reduced their services to 10 domestic respondent banks. According to the supervisory authorities in another country, between December 2015 and January 2017, 35 CBRs were closed, but 10 new CBRs were established during the same period creating a net loss of 25 CBRs. In this country, the bulk of terminations and restrictions in CBRs occurred in 2016. In another country, close to 60 percent of all banks had CBRs terminated between 2013 and 2015. In another country, even though the banking industry did not express any concern about derisking, all banks had at least one CBR terminated.

Some banks have been more affected than others by CBR terminations, while other banks' CBR networks have actually grown. Interviews with bankers suggest that the scale and frequency of CBR terminations have not been the same among all banks in one country or among countries. In one jurisdiction, some banks lost many more CBRs than others: one bank lost 10 CBRs and was unable to open more than one new relationship, while another bank lost 25 correspondent banking accounts but reopened 27 new accounts with different correspondent banks. In another country, a bank claimed the loss of one account, but in a short time it was able to reopen a new relationship with almost no disruption to customer service. On the other end of the spectrum, a global bank derisked a bank in the same country with which it had a relationship of more than 30 years. The bank that was derisked now depends on only one global correspondent bank for its cross-border transactions. Also, there are cases where banks did not lose any CBRs and even managed to increase the number of CBRs. In one of those countries, banks have remained basically untouched by derisking.¹³ Further, in one country, state-owned commercial banks have been

more derisked than private commercial banks and foreign commercial banks.

However, all banks have been able to maintain, restore, or establish new CBRs. In several countries, the withdrawal of CBRs led to a net reduction in CBRs but remained relatively contained overall, as banks could find alternative arrangements. In one country, for example, about 158 nostro and MTO-related accounts were terminated over the past four years, but many of the affected banks were able to establish new relationships with other financial institutions. A total of 52 new relationships were established by those banks in that country. Further, one of the most prominent banks in a jurisdiction saw its CBRs cut off several times since 2012, but it was always able to offset the closing of accounts by opening new CBRs over the same period. In conclusion, except for one bank that will be discussed subsequently, no case was reported where an institution was left without any CBRs at all. The majority of banks are still enjoying multiple correspondent bank accounts in several currencies with several counterparts—from countries belonging to the Organisation

for Economic Co-operation and Development (OECD) and from non-OECD countries—and have maintained multiple relation management applications (RMAs).¹⁴ Banks keep opening new relationships.

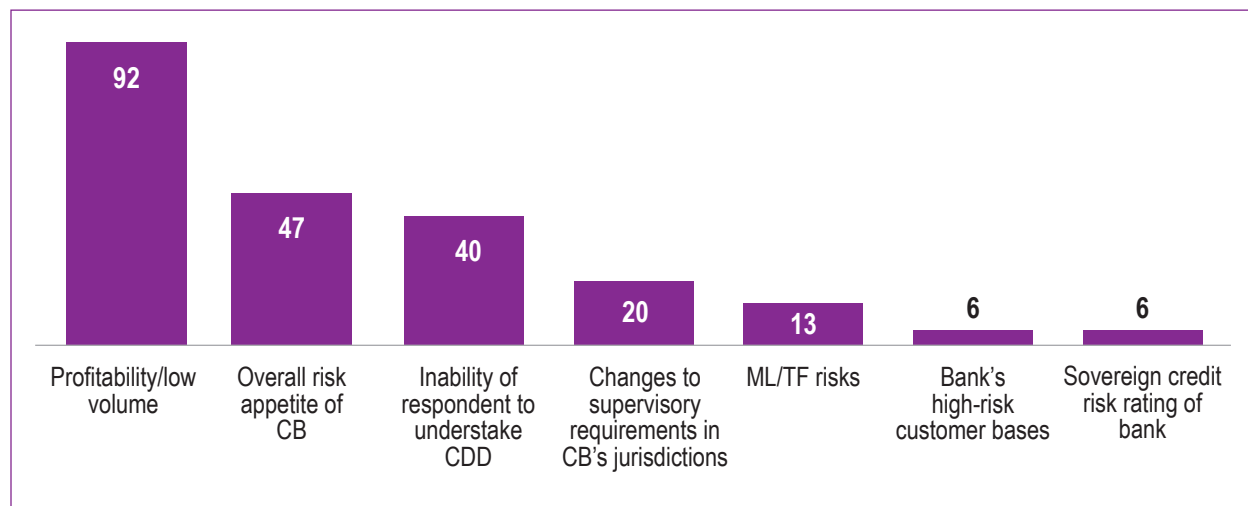
A lack of profitability and concerns about AML/CFT compliance by respondents—or by the jurisdiction they are in—remain the key drivers of CBR closures. There are many causes of derisking. The WBG’s 2015 global survey identified two groups of drivers of the decline in foreign CBRs.¹⁵ One category of causes is more business related and explains the decision to terminate a foreign CBR in purely economic terms. The second category of causes is more regulatory and risk related and explains the decision on (a) the basis of the money laundering and financing of terrorism (ML/FT) risk level of the counterpart being unmanageable and (b) concerns about international and regional sanctions. The analysis of the responses to the questionnaires used in this survey and the subsequent onsite interviews confirm this. Even though respondent banks complained about the absence of transparency from their correspondents, the lack of profitability and

AML/CFT compliance issues were identified as the key reasons.¹⁶ In several instances, global banks severed their relationships because of the absence of activity with their respondents.¹⁷ Many banks also mentioned overall risk appetite of the foreign institutions, changes to regulatory requirements in foreign jurisdictions and concerns about money laundering risks as causes for decline (figure 1).¹⁸

Banks with large international operations are driving CBR terminations. Global banks, mainly from the OECD (for example, the United States and the European Union [EU], but also from Canada and Australia), have been the main banks closing CBRs. In 2015 in one country, 10 accounts were terminated by U.S. banks (from a total of 37), and all of those were in USD. Moreover, United Kingdom and Canadian banks terminated 14 percent and 17 percent of nostro accounts, respectively, in this country; another prominent U.K. bank terminated all its CBRs altogether. The same pattern was observed in another country in the sample.

However, in only a few cases did these banks withdraw all CBRs from a jurisdiction, suggesting that concerns about countries were not

Figure 1. Causes to terminate or restrict CBRs in one of the surveyed countries



Source: Central Bank data 2016 (number of respondents to the Central Bank survey).
 Note: CB = central bank; CBR = correspondent banking relationship; CDD = customer due diligence; ML/TF = money laundering/financing of terrorism.

the reasons for withdrawing. Some OECD banks exited entire regions because of strategic decisions, but many continued operations with selected local players. In addition, in certain Caribbean countries (a region particularly affected by the withdrawal of CBRs), some of these banks with large international operations are back in business. According to respondent banks, indications are that these international banks and other operators are exploring business opportunities again. One U.S. and two Canadian banks were all mentioned

as recently having established new relationships. Table 1 summarizes account closures in one of the countries surveyed, as of October 2017.

Direct effects of closing and restrictions of CBRs on banks

At the microlevel, only a few banks have been hit severely by CBR terminations. Several cases were reported of banks being affected by the loss of their relationships. Across all countries surveyed, banks

Table 1. Summary of survey on account closures in one surveyed country

No.	Countries of banks providing CBRs	Type of account closed			Total accounts closed	Foreign banks involved
		Nostró	Bank sub	Remco and tie ups		
1	Australia	1		51	52	6
2	United Kingdom	5	5	10	20	7
3	Hong Kong SAR, China	5	12	1	18	9
4	Canada	4	2	11	17	8
5	United States	2	8	4	14	5
6	New Zealand	1		10	11	6
7	Italy		2	7	9	7
8	Singapore	1	2	1	4	3
9	Papua New Guinea			3	3	4
10	France		1	1	2	2
11	Spain			2	2	2
12	Germany			1	1	2
13	Saipan			1	1	1
14	Cyprus	1			1	1
15	Brunei			1	1	1
16	Austria		1		1	1
17	Ireland			1	1	1
Total		20	33	105	158	
Total countries/jurisdictions that withdrew CBR:					17	
Total foreign banks involved					51	
Total accounts closed					158	

Source: Industry Association Data.

Note: Bank sub= bank subsidiary; CBR = correspondent banking relationship; Remco = remittance company.

tended to be given very short notice—between 30 and 60 days at best.¹⁹ On a few occasions, banks came close to losing access to the international financial system. One bank contacted 42 potential correspondents in the United States, Canada, and Europe, and only one agreed to establish a CBR after a tedious six-month process. In the same country, a prominent bank lost all its CBRs for four months before it found a replacement; the bank lost its ability to meet some of its obligations and to provide credit card services in foreign currencies, and it suffered damage to its reputation. A few banks that lost their CBRs also tried to find alternative solutions locally by approaching their domestic competitors to use their own CBRs, but mostly without success. Banks that suffered the most usually claimed (a) the loss of significant numbers of customers, such as corporate companies and exporters; (b) a drop in volumes of remittances (in one case, as much as 30 percent); (c) the loss of highly profitable business²⁰; and (d) a negative effect on their ratings (see box 1).

The cost of establishing and maintaining new partnerships has increased for many institutions. If opening new accounts has not been especially challenging—with some exceptions described previously—banks acknowledged that correspondent accounts (including new ones) cost more to open and to maintain. The typical questionnaire to establish a new CBR (or to monitor an existing CBR) is about 90 pages. Increasingly, correspondents are requiring more detailed information on banks' customers and operations, with special attention to the initiator and the ultimate

beneficiary of a payment. Correspondent banks are also paying increased attention to their respondents' customer due diligence (CDD), demanding periodic updates. In addition, it is a common practice for correspondents to visit the sites to ensure that their respondents are complying with their AML/CFT obligations.²² Respondent banks also complained about their correspondents asking questions about their customers' customers (know your customer's customer, or KYCC) or, as observed in one case, about their customers' customers' customers (KYCCC). It is important to stress that KYCC and KYCCC go beyond the Financial Action Task Force (FATF) standards.²³

Even banks that did not lose any CBRs mentioned the challenges involved in maintaining their relationships and the need to respond to multiple and ongoing queries from their correspondents. The same holds true for the other side; according to a prominent correspondent bank, CBRs used to be handled only by a few people. Now, they have entire teams for this. Rising compliance costs associated with more stringent AML/CFT regulations and international sanctions regimes make correspondent banking services less financially attractive, which, along with heightened reputation costs, leads correspondent banks to cancel services.²⁴

Restrictions also have been imposed on new correspondent banking relationships. In addition to higher CDD costs and heightened scrutiny, many banks have also claimed pressures from their correspondents to limit their exposure to certain

Box 1. The effect of the termination of CBRs on a bank's ratings

In one jurisdiction, a prominent bank that had issued a bond of approximately USD 150 million found itself losing multiple corresponding banking relationships (CBRs) and facing market concerns about the bank's capacity to pay the quarterly coupon to investors. As a result, the bank's ratings were downgraded by two internationally reputable rating agencies three levels (to Caa1 from B3).²¹ In its statement, one of the agencies indicated that the bank's ratings could be downgraded further if the bank did not manage to obtain new, stable, and reasonably priced correspondent banking lines in a timely manner. The bank considered this downgrading to be the biggest long-term impact of derisking. This rating slide alone could make it even more difficult for the bank to find alternative CBRs.

categories of customers (for example, remittance companies, MTOs, and nonprofit organizations) to certain lines of business and to certain countries outside of the correspondent's appetite for risk. In one country, for example, this pressure from correspondents on their respondents to reduce relationships with MTOs and foreign exchange traders led to a trickle-down effect. At the end of 2014, 80 percent of this country's foreign exchange traders had foreign currency accounts with local banks; by 2017, this number had dropped to 51 percent. An MTO reported that 50 percent of its subagents lost their local bank accounts completely. In other countries, banks also claimed that their new CBRs were subjected to restrictions (for example, caps being placed on certain transactions) or limitations (for example, prohibiting nesting and downstream clearing, checks and drafts clearing, and online gambling). Further, correspondent banks sometimes ask their new respondents to pay higher due diligence fees, to execute a minimum volume of transactions per month, and to make significant deposits upfront as a precondition for opening a new CBR account.

3.2 The termination or restriction of accounts in the remittances market

Officially recorded remittances to developing countries are expected to reach USD 450 billion in 2017, up from USD 429 billion in 2016 and recovering after two consecutive years of decline.²⁵ Global remittances, which include flows to high-income countries, are projected to grow by 3.9 percent to USD 596 billion. According to the World Bank, currently the global average cost for sending remittances is 7.32 percent while the International MTO Index is at 8.20 percent.²⁶ Banks remain the most expensive type of service provider, with an average cost of 11.0 percent. Derisking practices by global financial institutions threaten to cut off access to the global financial system for remittance companies and local banks in certain regions, putting them at risk of losing access to the global financial system.²⁷ According

to data gathered by the World Bank and in light of the current country case studies, MTOs and other remittance companies are the most exposed to the derisking phenomenon.²⁸

The flow of funds from migrant workers back to their families in their home country is an important source of income in many developing economies. The recipients often depend on remittances to cover daily living expenses, to provide a cushion against emergencies or, in some cases, to fund small investments. Remittances are among the largest source of external resources in developing countries, and for some they are equivalent to as much as one-third of gross domestic product (GDP). Moreover, the flow of remittances seems to be significantly more stable than other forms of external finance.

MTOs and remittance service providers (RSPs) have been particularly affected by derisking because their business is cash intensive. Banks are often reluctant to accept business from those who are not customers or depositors. Walk-in clients who are not depositors of the bank and who bring cash for a remittance transaction will most likely be turned away. Interviews with banks suggest that some of their concerns with MTOs and remittance companies are about (a) risks to the banks' reputations, (b) the banks' fear of scrutiny and large penalties from local regulators, (c) the banks' lack of confidence in the RSP's AML/CFT procedures, and (d) the banks' reassessment of the risk-reward tradeoffs of providing accounts to MTOs.

As a result, global financial institutions have instituted risk mitigation measures by severing ties with MTOs. In almost all visited countries, MTOs' bank accounts were closed, leaving many of them unable to make deposits and international wire transfers. Because of the restrictions put on CBRs by global banks, fewer local banks are willing to provide banking services to MTOs. In one country, for example, four of the five MTOs interviewed affirmed that at least one of their agents had bank accounts closed or restricted for international money transfers. In a second country, three of eight MTOs

operating in the country are struggling to remain viable as all had their business bank accounts closed. In a third jurisdiction, remittance accounts had been closing before 2010, but that has accelerated between 2012 to 2016 with 17, 24, 37, 27, and 20 accounts closed, respectively, over the five years. Closings continue (see table 2). In a fourth country, one bank closed 42 of 56 foreign exchange trader accounts so that the bank could keep its CBRs with global banks. Another institution made the decision to stop banking MTOs' subagents altogether for the same reason.

The effects of the closures and restrictions of correspondent banking services to MTOs have caused stressful and disruptive situations for

these entities and those dependent on them, such as nonprofit organizations. In one country, for example, one MTO that operates globally and processes inbound remittances from the United States described a situation in which a local respondent bank froze its six accounts for three days. The respondent bank ultimately closed all of the accounts in June 2016 without notice, at the instructions of its correspondent bank, which decided to stop doing business with MTOs. These accounts were used not only for transactional operations but also for paying staff salaries and checks. It took three days for the MTO to recover its USD 50 million in assets and much longer for beneficiaries to collect their funds. Of particular note is another country where banks and MTOs still

Table 2. Remittance operating account closures, 2010–2017, in one surveyed country

Remittance account closure trend- 2010 to 2017									
No.	Countries	2010	2011	2012	2013	2014	2015	2016	2017
1	Australia			5	5	13	12	8	8
2	United Kingdom			1	6	2	7	2	1
3	Canada	2	2	5	2			3	2
4	Hong Kong SAR, China		2	2	4	3	3	2	
5	United States			2	2	6	2		
6	New Zealand		2		1	3		4	
7	Italy				2	5	1		1
8	Singapore		2	2	1				
9	Papua New Guinea					3			
10	France						1	1	
11	Spain								
12	Germany				1		1		
13	Saipan					1			
14	Cyprus								
15	Brunei		1						
16	Austria					1			
17	Ireland								
	Total	2	9	17	24	37	27	20	12

Source: Industry data from one surveyed country.

Note: Some of the accounts reported closed occurred before 2010, or no date reported.

III. MAIN OUTCOMES OF THE COUNTRY CASE STUDIES

have access to accounts in targeted markets but have been forced to switch from larger (international) banks to smaller local, community, and thrift banks. This substitution of global banks by second-tier entities warrants close attention (see discussion under section 3.5).

Higher operation and other related costs led some of the MTOs to resort to unconventional methods. Derisking poses many challenges to MTOs. On one side of the transaction, the closing of bank accounts threatens their ability to secure funds in the host (sending) country; on the other side, a (potential) lack of liquidity in the home country undermines the MTOs' capacity to make payments to beneficiaries. Most MTOs interviewed continue to operate despite this threat with financial support from other businesses or private funding by their owners. Such practices, albeit temporary in nature, undermines accountability, transparency, and ultimately viability. In another instance, an MTO in Australia lost access to its bank account and had to find an alternative arrangement to transfer remittances. As an interim solution, the MTO is using a cash logistics company to collect cash from the MTO's outlet locations and to deposit cash in the cash logistics company's account from where it is then wired to the MTO's correspondent account. This operation has increased the cost of remittance services by 33 percent (from AUD 6 to AUD 8 per remittance transaction). In another country, remittances continue to be serviced through well-known providers, but some of the smaller operators that no longer have bank accounts in the sending countries are using alternative practices to remain in business. These practices include, for example, the use of personal bank accounts to channel money or the use of commercial couriers to carry cash between the sending and receiving countries. None of these alternatives are sustainable.

In conclusion, the effects of closing or restricting MTOs' accounts go beyond the impacts they have on MTOs' operations or cost structure. It also affects remittances clients, their agents, and the entire industry. Banks are competitors to MTOs—and competition is distorted when banks close MTO accounts.

3.3 Impact on various types of customers, products, and services

Effects on bank's retail customers

The impact of derisking on banks' customers has been acute in several instances. Interviews suggest that, globally, the increase in costs of banks generated by the higher compliance costs related to AML/CFT regulations and that, currently, the requirements of international correspondent banks are not being passed on to clients. In most cases, it is absorbed by the banks. However, cost increases can be significant. In one country, a bank indicated that its costs per transaction in switching CBRs had risen from USD 9 per transaction, to USD 50 to 60. In another country, a building society lost its CBR with a U.K. bank but was able to reopen a new CBR with a U.S. bank. Yet this shift entailed an increase in cost for clients—predominantly pensioners of the country that used to work in the United Kingdom. Those clients now have to transfer their pension payments to their home country via wire transfers, which entails a cost of USD 40 per transaction, an amount that is not insignificant for these customers. In a third jurisdiction, the cost of studying abroad is becoming increasingly expensive for the students and families of that country. Because of derisking, local banks lost their nostros accounts in Australian and Canadian dollars. Consequently, tuitions fees and living expenses can only be remitted through intermediary third currencies (most often USD); that results in a dramatic increase in transfer costs (an extra charge of USD 60 for cross-currency transactions, in addition to the flat fee applied by the bank for each transaction).

Effects on trade finance

The impact of derisking on trade finance is getting increased attention at the global level. In a recent publication, the IFC stated: “because bank-to-bank relationships represent a key element in cross-border transactions, declines in CBRs put trade finance at risk. This has the potential to hurt trade in both rich and poor countries.”²⁹ The International Chamber of Commerce also noted

that because of AML and KYC, 62 percent of participants in a recent survey have declined trade finance transactions, and three-quarters of the banks said that small- and medium-scale enterprises (SMEs) were the most adversely affected customer group. The industry has also raised concerns about the effect of CBR terminations on trade finance, driven by the high costs of KYC compliance.³⁰ Globally, correspondent banks processing trade finance transactions are reducing the number of active RMA keys to reduce KYC costs.³¹ As in cash clearing, this reduction could affect banks and their clients in some regions, specifically in emerging countries and for SMEs.

The experience of the eight surveyed countries does not indicate a direct effect of derisking on trade finance, and further analysis is needed.

Activities that consume capital or leverage are more prone to be reconsidered by global banks; such activities include trade finance (which requires cash upfront), long-term funding in USD, large derivative uncollateralized trades, and provision of liquidity withdrawals. Derisking has resulted in disruptions to established businesses because of increased cost in operations and diminished quality of services provided to exporters and importers. But in none of the eight countries was this considered a significant problem, and only one country indicated some concern. In that country, more than 90 percent of trade is settled in USD.³² There, a few banks claimed that the closure of CBRs—even in small proportion of cases—has adversely affected their business, particularly on trade finance. One bank claimed a loss of 10 percent of its trade services, and another lost between 10 to 15 percent of its trade finance business.

Effects on remittances' recipients

The direct impact of CBR terminations on the cost of remittances is unclear, because the price development of remittances in different countries is decidedly mixed. Even though many MTOs in the visited countries have provided insights into the increase of the operation costs of their remittance services, the direct effect of derisking on the

average cost of remittances is still unclear. While some countries have experienced a rise of their average cost of remittances in the past year, others have seen a decrease in the cost. For example, the cost of sending money to one country through its most important corridor increased 2 percentage points over the past year, from 8.1 percent to 10.1 percent. Similarly, in another case, the cost of sending remittances to the country increased from 4.0 percent to 4.8 percent between Q2 2016 and Q2 2017. Another jurisdiction also reported an increase in the cost of remittances for the same period. However, both countries saw a decrease between the Q3 2016 and Q3 2017. In other jurisdictions, a different scenario unfolded, despite severe derisking. In one country, for example, the cost of sending inbound remittances decreased in its most important corridor, from 5.3 percent in Q3 2016 to 4.3 percent Q3 of 2017. The same downward trend occurred in another country.

The impact of derisking on remittance inflows also varies from one country to another. The volume of migrant remittances inflows into the visited countries also merits analysis. In four surveyed jurisdictions, the volume of remittances into the country decreased in the past five years, in one country as much as 79 percent from 2012 to 2016 and in another by 32 percent. However, in a third country, where some European banks explicitly asked local banks not to use their correspondent banking services for activities related to remittances, remittance inflows are still increasing. Most recent data in this country indicate an upward trend in remittances. CPMI also reported in July 2016 for this third country a marginal loss of CBRs (–2 percent) and an increase in value (16.2 percent) and in volume (48.4 percent) over the period of 2012–2015. In a fourth country, the effect of derisking on remittances seems to be negligible. Remittances to this country increased to USD 2,292 million in 2016 from USD 2,226 million in 2015 and have continuously grown over the past 15 years (from USD 968 million in 2001).

It is therefore difficult to draw definitive conclusions on the effect of derisking on remittances because

other factors might be in play. Most literature on remittances finds that the drivers for the cost of remittances depend on, among other things, (a) the type of corridor, (b) the number of migrants living in the sending country, (c) the competition in number of MTOs and banks, (d) regulation and government policies, and (e) the size of the country. Remittances are a volume business, and for small states in particular, volumes are by definition small. That means that the level of competition among MTOs can be quite low, and one or two companies might have control of the market and the cost. In one surveyed country for example, the market for remittances is not very efficient and the price of sending and receiving remittances continues to be high (between 10 and 11 percent).³³ Money transfers through banks are expensive and most people prefer to rely on MTOs. As the smaller MTOs are being squeezed from the market because of bank account closings, some funds are deflected to the larger MTOs that generally price higher than the smaller operators. However, in some cases the cost for sending remittances is much lower in small states.³⁴

Effects on nonprofit organizations and charities

In the country studies, access for nonprofit organizations (NPOs) and charities to finance did not come up as a significant issue. In one country, a respondent bank was instructed by its correspondent to stop doing business with nongovernment organizations. In a second country, domestic respondent banks indicated they do not consider NPOs and humanitarian organizations to be high risk, but have noticed their correspondents do. Other than that, this topic was not raised.

However, other studies have shown that in certain jurisdictions, including those that are developing, NPOs are having problems opening bank accounts and, in particular, moving funds internationally. Pervasive views of charitable customers as being particularly vulnerable to terrorist financing have resulted in NPOs

automatically being considered high risk. During the past several years, there have been an increasing number of reports of humanitarian assistance and other vital services being stymied by an inability to transfer funds internationally. Several reports released in 2017 indicate significant problems for many different kinds of NPOs in all parts of the globe providing essential services, often in conflict zones and inaccessible regions.³⁵ A random sample survey (focused exclusively on American NPOs) found that two-thirds of U.S. NPOs working internationally experience banking difficulties.³⁶ The most frequent problems include wire transfers delays (37 percent), excessive documentation requests (26 percent), and increased fees (33 percent).

As a result, NPOs have adopted coping strategies that are contrary to AML/CFT objectives. All these difficulties combined have led charities to adopt strategies to move funds through less transparent, traceable, and safe channels, with 42 percent resorting to carrying cash. These coping mechanisms not only put NPOs at risk, but also can undermine AML/CFT objectives by driving financial transactions outside of regulated channels.

Derisking challenges are affecting all types and sizes of NPOs, including putting pressure on the operations of larger, well-known, international humanitarian organizations. NPOs operating internationally use currency dealers to disburse funds in local currency to provide goods for humanitarian purposes and to pay employees or contractors. These currency dealers have accounts in local banks, but often are considered MTOs in the eyes of correspondent banks and have had their accounts closed. In addition, some local banks with whom NPOs work have lost their CBRs in some countries. This situation puts international organizations and NPOs at risk of delays when emergency aid needs to be delivered quickly. Moreover, it increases NPO costs by having to deliver aid in OECD currencies at higher rates (around 3 percentage points difference) in cases where local banks are unable to process the transactions.

3.4 The cross-border effects of derisking

There have also been cross-border effects of CBR terminations, especially in certain countries in Sub-Saharan Africa (SSA). Banks headquartered in one country, but with a strong presence in the entire SSA region (39 subsidiaries in total), have not themselves been derisked in their own jurisdiction but are derisking their relations in other countries in the region. These structural features explain, to a certain extent, why the effect of derisking can easily spread throughout the region and can have unintended cross-border spillover implications.

Only a few CBRs in this visited country have been terminated or restricted, yet several countries in the Southern African Development Community region have been seriously affected. U.S. and European banks have not terminated relationships with the respondent banks in this country, but relationships between the respondent banks and their affiliates in other parts of Africa have been terminated or restricted, either as a business decision or under pressure from correspondents. In effect, foreign correspondent banks (mostly in the EU) have withdrawn from certain geographies and from certain client categories in Africa given their limited risk appetite, the increased cost of maintaining relationships, and the low volumes. In several instances, respondent banks were pressured to stop doing business in neighboring countries if they wanted to maintain their CBRs with their Western partners. The cross-border spillover effects of derisking in the region has now become a concern at the regional level.

Local banks think that local risks are not always well understood. The respondent banks consider that decisions about terminating relationships are often made on the basis of a (high-income) understanding of risk (for example, high-value cash transactions equal high risk) without a fuller understanding of the market or the entity, making jurisdiction risk all-decisive. At the same time, some of the respondent banks recognize that the

withdrawal by EU banks presents them with a business opportunity.

Angola was found to be particularly affected by CBR terminations. This report did not include Angola as one of the surveyed countries, however, the WBG team had a video conference with Angolan authorities and local banks to discuss the regional perspective. In Angola, six Angolan banks were previously routing foreign currency transactions via a bank in another country, and these services were terminated. Fifteen Angolan banks were also previously receiving their USD notes from the same institution and this service was ceased in December 2015, at the request of the notes supplier, a US bank. At present, USD notes are available through so-called down streaming and nested relationships between subsidiaries of Angolan banks in third countries (in the EU and Africa) and in others (Asia). CBRs denominated in USD are still vital to the Angolan banking system, given Angola's dependence on international trade but actually it has been turned to euro.³⁷

Angola is taking action to mitigate the consequences of CBR terminations. The cost of doing business has also risen because the country has lost some relationships with international banks, which has in turn further weakened the nation's financial system as it struggles with lower oil prices and high nonperforming loans. Because of the USD shortage, the import of food is particularly challenging given that 90 percent is imported. Almost every sector of the economy, including medicine supply, has been affected by derisking. Also, the problem of dollar supply has affected small entrepreneurs who do business with the Brazil, China, South Africa, and United Arab Emirates. The fact that certain operations now have to be denominated in euros increases the cost to the user. According to the authorities, inflation has also increased as a result. Angolan authorities and banks are trying to address the compliance concerns of U.S. regulators to normalize USD correspondent banking relationships, and some progress has been made.³⁸ However, on the basis of feedback from industry participants, rating agencies do not expect

USD correspondent bank services to return to normal soon.

Angolan banks are not the only African banks facing challenges meeting USD obligations following loss of correspondent bank relationships. Review of recent literature³⁹ shows a noticeable decline in CBRs in the region, and the effect is a significant concern in dollarized countries. Domestic banks have less access to external financing, face payment delays, and are subject to additional transaction costs and liquidity constraints. International banks perceive certain African jurisdictions to be higher risk, as well as posing specific institutional risks, and view the compliance costs as outweighing the relatively low profits. Strengthening the regulatory framework, including the AML/CFT regimes, and strengthening enforcement will be important to maintain existing CBRs.

3.5 Other potential implications of CBR terminations

The concentration of MTOs and remittance flows within a limited number of banks raises the prospect of systemic risks in a few countries. The withdrawal of banking services to MTOs has led to a concentration of MTOs' accounts and remittance flows in a limited number of banks. In one of the countries, all three major remittance operators are now operating with the same domestic bank. Smaller MTOs are also likely to be holding accounts with this bank as there are only two significant commercial banks in the country. Because the leading bank no longer accepts MTOs, all the accounts are effectively pushed to the other bank. A systemic risk is created by this concentration of MTO accounts in one single institution.⁴⁰ Similarly, in a third country, about 91 percent of remittances are processed by a handful of banks. As a result, a more severe derisking of those banks—particularly of the one bank which processes more than 49 percent of country's remittances—could have significant consequences on the local economy. Another manifestation of concentration risks appears in a fourth country where a bank maintains

commercial relationships with 35 foreign exchange traders. When processing remittance transactions, the foreign exchange traders credit funds to this fourth country's bank's USD nostro account that is held with a global U.K. bank. The latter is the only correspondent of the domestic institution that accepts funds originating from MTOs. Consequently, that makes the remittance business in this country vulnerable to any changes in this U.K. bank's policies.

The withdrawal of CBRs is leading to structural changes in banking. Recent developments in the banking sector are noteworthy in a few visited countries. In one country, a global U.K. bank has left the country altogether, while other OECD banks have reduced their relationships with domestic banks. Most of the banks that have been derisked have established new relationships not only with global banks but also with nonsystemic and non-OECD banks, including from India, Pakistan, Saudi Arabia, and United Arab Emirates (UAE). In several instances, new alternative CBRs have been set up with the UAE only.⁴¹ The limited pool of correspondents that has agreed to partner with domestic banks increases systemic risks in that country.

Further, the replacement of CBRs by second-tier banks also raises concerns about integrity that warrant authorities' attention. In several instances, correspondent banking services are now being offered by regional banks instead of by global banks. As discussed previously in this report, where global banks have terminated correspondent banking services, local banks and MTOs have found ways to maintain their operations in order to survive. However, in some cases top-tier banks have been replaced by second- or third-tier banks, a situation that has been observed in surveyed countries in several regions including EAP, LAC, and SSA. Authorities must closely scrutinize the internal procedures of banks that have recently started to provide correspondent banking services to ensure they are aligned with local and international standards. In some cases, banks whose CBRs were severed by global banks opened a new relationship

with a bank that was recently ordered out of the United States for failing to comply with AML/CFT laws and regulations.⁴²

Informality has resurged in one place as a possible unintended result of derisking. The termination of CBRs for MTOs may be driving some customers to alternative banking solutions especially among countries' expatriates. With the loss of familiar MTOs because of derisking, customers have two choices: (a) to use a new provider, with higher compliance requirements and potentially higher costs, or (b) to use an illegal supplier with no compliance requirements and a lower cost. Given those options, authorities in one surveyed country said many customers were moving to unregulated channels. In effect, derisking has affected clients' ability to access regulated MTOs in some areas and has increased the cost of MTOs' services. Therefore, some MTOs are losing customers who are now resorting to informal channels, especially *hawalas*, an informal money-transfer system in which an expatriate transfers an amount of money to an agent wherever they are based, and an equivalent payment is made in local currency in the receiving country.⁴³ Hawala channels are cheaper, faster, and handle at least as much in remittances as banks, without foreign currency ever crossing the border.

These trends represent a significant challenge for the authorities as they could undermine AML/CFT objectives by making millions of financial transactions untraceable.

In some cases, derisking has not in itself created a problem but has exacerbated an already existing problem. The prime example is the use of cash, notably U.S. dollars, in certain countries or regions. The case of one country is particularly compelling. In 2014, one global U.K. bank that provided cash shipment services in this country left the entire region, leaving only one U.S. bank offering this service. The U.S. bank has prohibited its respondents in this country and the entire region from accepting cash deposits originating from foreign exchange traders and MTOs. Furthermore, the same bank has also put limits on the volume of USD-denominated cash to be deposited by its respondents. As a result, in an economy where tourism accounts for 30 percent of GDP, the limits on depositing cash in USD create piles of cash that cannot be deposited. Therefore the risk increases. Operators are either keeping the cash in their vaults or moving the money around using couriers, thus exposing staff members to assaults and to robbery. Some are also selling their USD surplus at a discount to informal traders.

IV. POSSIBLE SOLUTIONS AND GOOD PRACTICES

4.1 The role of the public sector

The following recommendations are based on the country studies only. They are examples of measures considered or taken in those countries that may be relevant to other countries. They do not cover all the negative effects resulting from derisking because the country studies did not show some of those effects (for instance, access to trade finance or the inability of charities to access funds).

Ongoing surveillance mechanisms and contingency planning

National authorities are encouraged to gather data on CBR closings and on nostro-vostro accounts in banks. Derisking is still happening, and authorities are encouraged to consistently collect data on the state of their CBR relationships and to establish permanent monitoring for forward-looking risk assessment. Several of the surveyed countries have started monitoring trends in CBRs, and some intend to do so through their banking supervisor's off-site monitoring department. One of the countries visited was creating a standard form that would be submitted by banks quarterly on the number of CBRs maintained. This reporting could encompass not only banks but also MTOs. To that end, the IMF has conceived an innovative framework that can be readily used by central banks and supervisory authorities to collect data and effectively monitor the developments of CBRs in their jurisdictions.⁴⁴

Public authorities should design a contingency plan to address any severe deterioration in CBRs. In all visited countries, there was no real plan to manage and mitigate the effects of derisking. National authorities should design contingency planning to prevent, mitigate, and manage real crises when they emerge and define remedial measures ex ante. This plan should be designed not only to prevent a systemic crisis in key sectors

such as remittances but also to provide assistance should domestic banks experience more severe termination of restrictions in CBRs or should MTOs be derisked. In that regard, several stakeholders claimed that there should have been more help or guidance from regulatory authorities earlier. Supervisory authorities should develop a strategy to keep track of banks actively looking to secure new, stable, and reasonably priced correspondent banking lines, and those authorities should also be ready to provide emergency support.

Dialogue between respondents and correspondents

Authorities should encourage an ongoing dialogue between respondents and correspondents. This essential step ensures correspondent relationships are maintained. Derisking is a complex phenomenon that requires communication between all those who directly or indirectly play a role in correspondent banking. A lack of awareness and understanding of country context and risk is often a contributing factor to a bank's decision to withdraw its services. For that reason, countries should make extra efforts to establish an ongoing dialogue with the international banks that operate in their jurisdiction. Familiarity with each other's practices and developing personal business relationships are essential preconditions for respondents and correspondents to ensuring relationships are maintained. The purpose is

twofold: on the one hand, such dialogue will inform the international banks of ongoing initiatives by country authorities or in their institutions, and on the other hand, the dialogue will help respondent banks to understand the expectations of the correspondent banks and learn their practices.

Improvements to AML/CFT regimes in a risk-based approach

According to all studies conducted so far (by the IMF, FSB, CPMI, and the WBG), concerns about a respondent bank's AML/CFT regime are among the primary reasons for terminating CBRs. Thus, the improvement of the AML/CFT

regime by the respondent bank's jurisdiction is a crucial element of any strategy to try to maintain the confidence of the correspondent banks (see box 2). Equally important, such improvements should be well communicated. Whereas this paper is not the place for an extensive discussion of all the structural elements of an AML/CFT regime, a country should be able to show the strength, clarity, and detail of its AML/CFT laws and regulations. A country should also be able to show the rigorous enforcement by supervisory and law enforcement authorities of those laws and regulations and the application of those laws by financial institutions. In one country, the central bank ran a "road show" in the United States aimed at reassuring U.S.

Box 2. Improvements to AML/CFT regimes: The case of Somalia

To mitigate the risks associated with the loss of CBRs, authorities can consider a range of actions that seek to foster higher standards of transparency and compliance with international financial standards from banks and MTOs. Drafting AML/CFT regulations tailored to a specific sector such as MTOs can greatly improve the formalization, transparency, and compliance of actors who operate in sectors vital to the economy such as remittances: in that regard, consider the case of Somalia.

The population of Somalia is heavily dependent upon remittances from abroad. Each year, the Somali diaspora remits approximately USD 1.3-1.5 billion to relatives and friends in Somalia. In May 2013, a U.K. bank said it intended to close the bank accounts of the Somali remittance company Dahabshiil and approximately 100 other money transfer companies in Somalia. This action followed a corporate decision to derisk from certain business lines with perceived higher risks of ML/FT. As remittances are estimated to account for 24 to 45 percent of Somalia's GDP, the threatened withdrawal of the U.K. bank and other banks providing correspondent banking to Somalia raised significant concerns.

In response, the Federal Government of Somalia with the technical assistance of the World Bank and other international partners is undertaking a policy and institutional reforms program. The Supporting Remittances Flows to Somalia Project, backed by funding from the United Kingdom, includes measures to improve the formalization, transparency, and compliance of the remittance providers in Somalia. The project supports the efforts of the Central Bank of Somalia (CBS) to begin formal supervision of the Somali MTOs with the assistance of a "trusted agent" (an external firm procured by the World Bank) to work alongside the CBS for four years to establish onsite and off-site supervision of MTOs. In March 2016, the World Bank selected the Norwegian firm Abyrint as the trusted agent.

To strengthen the regulatory framework for the MTO sector, the World Bank worked with the CBS to draft MTO regulations. The regulations focus on two key areas: (a) regulations for operation purposes, including provisions for, among others, customer due diligence, recordkeeping, ongoing monitoring, reporting, internal controls, consumer protection and risk management, which would apply to all registered and licensed MTOs operating in Somalia, and (b) regulations for customer registration, which would apply to customers (individuals and businesses) of all MTOs to ensure everyone a fair and equal chance at succeeding. The trusted agent will work with the CBS to ensure that the MTOs and their agents comply with the regulations and meet the requirements on an ongoing basis.

supervisors that the country's AML/CFT regulatory framework was robust and had been improved, for example, by establishing a national identification system set to roll out in 2018. The project aims to establish a reliable identification system for citizens and other nationals that are residents in the country, with a unique national identification number as the primary identifier of a resident. For financial institutions, it will make the identification and verification process seamless. Such an identification system will also contribute to increased confidence in the KYC/CDD process and, in turn, provide comfort to foreign correspondents.

At the same time, a country needs to be open about its vulnerabilities and risks: a country needs to show that it is adopting a risk-based approach to AML/CFT and allocating its resources accordingly. Country context is one of the determining factors for a correspondent bank in assessing the risk level of the respondent. If a country shows it is doing well on that front and is adopting a risk-based approach to supervision of AML/CFT, that effort will positively affect the risk rating of the respondent and thus increase the willingness of the correspondent to establish a CBR.

For a country to be able to adopt a risk-based approach to AML/CFT, it will first need to undertake a detailed assessment of its system. To adopt such an approach requires an evaluation of the weaknesses of all private and public institutions responsible for developing, applying, or enforcing AML/CFT legislation. Those institutions range from policy-setting bodies to reporting entities such as banks and the so-called designated nonfinancial businesses and professions and from the financial intelligence unit to the law enforcement, prosecutorial, and judiciary bodies. Furthermore, the approach requires an understanding of the threats to which a jurisdiction is exposed. Such an assessment should examine which crimes generate significant profits and where those profits are being laundered, in what sectors, and where they are finally invested. Having undertaken such an assessment, the country then needs to devise a plan that sets out how it will

deal with the risks—devoting more resources to the higher risks. Only then can it credibly claim to have both identified and mitigated its risks and, in the process, become a more attractive place for a correspondent bank.

The World Bank Group has designed a specific tool to assist countries undertake such a national risk assessment, which is being or has been used in more than 80 jurisdictions. In some instances, countries have sought to generate significant publicity for their risk assessment to publicly show what the country is doing, how it is seeking to increase effectiveness, and how it is addressing any negative impression of its AML/CFT system.

ISO-like certification for respondent banks

Respondent banks could be subject to an independent and transparent evaluation to be made by a reputable audit firm to determine the existence and effectiveness of their AML/CFT internal system. As already discussed, the lack of trust by global banks in countries' ability to meet AML/CFT international standards is one of the causes for derisking. In particular, local banks are not always subject to a thorough oversight by domestic supervisors. A more intrusive AML/CFT surveillance may provide comfort. An ISO-like certification process could also add credibility and demonstrate that respondent banks' AML/CFT systems meet international standards.⁴⁵

This solution increases the level of trust of correspondent banks. In one surveyed country, the central bank considered that the positive audit undertaken by a reputable third consulting company was a factor that helped reestablish CBRs with the audited financial institution. Thus, the positive audit counteracted the adverse impact of derisking. Such a certification process could be used for the MTO industry. In that regard, Australian MTOs have created an association, the Australian Remittance and Currency Providers Association, which is now trying to carry out compliance activities and has started a certification process that goes beyond its

national requirements. Such a move aims to (a) reassure banks about the reliability of the industry and (b) ensure alignment among MTOs in their discussions with banks and the government.

Improving regulatory oversight of MTOs

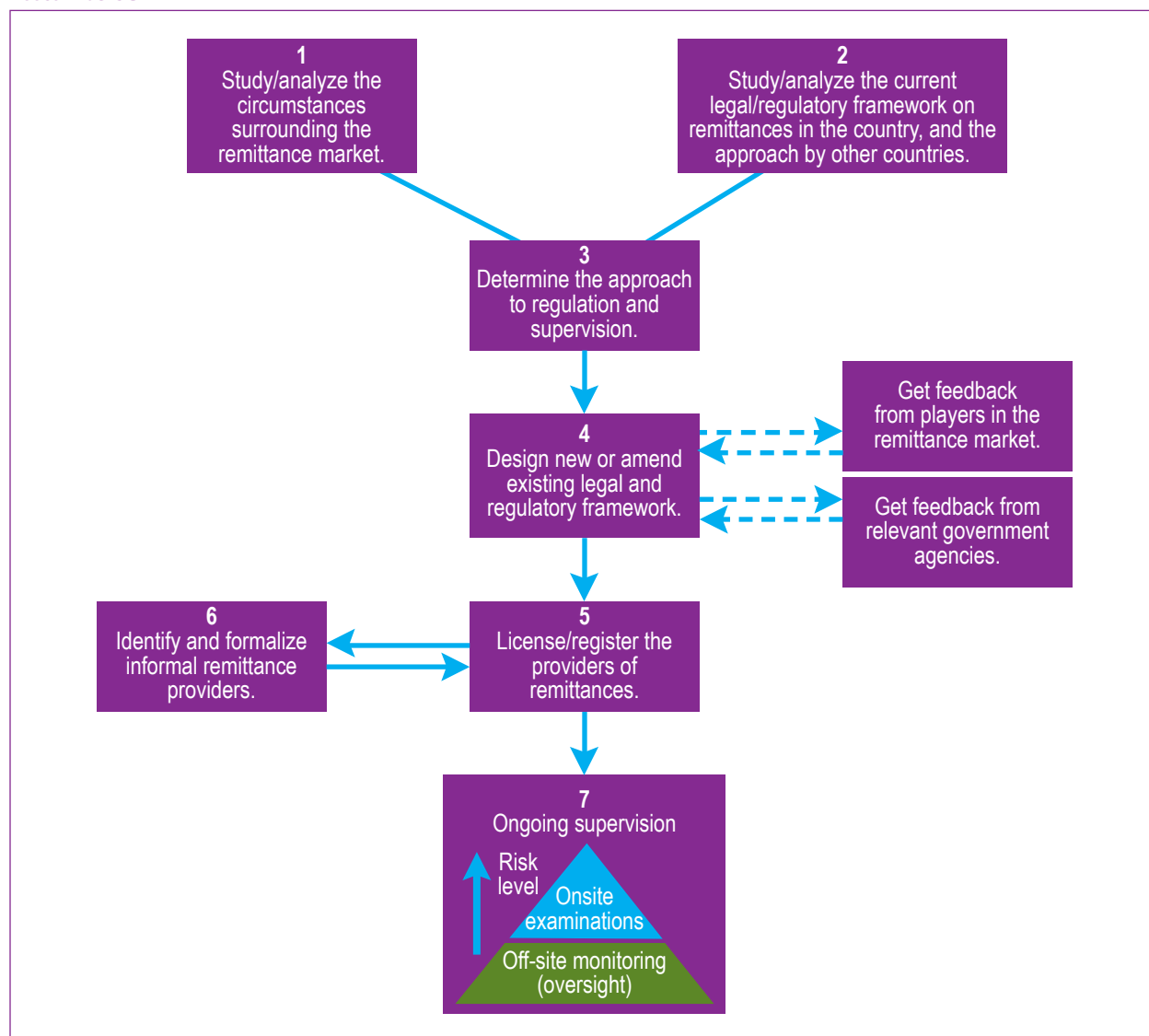
Improving regulatory oversight of MTOs should be at the forefront of any derisking strategy. The concern of the quality of regulation and supervision of the remittance industry is among the primary reasons for derisking. A first step to improving regulatory oversight and supervision of MTOs is to ensure the effective implementation of international standards. The World Bank's Committee on Payment and Settlement Systems General Principles for International Remittance Services set out principles covering five key areas: (a) transparency and consumer protection, (b) payment system infrastructure, (c) the legal and regulatory environment, (d) market structure and competition, and (e) governance and risk management.⁴⁶ The principles, which require a combined effort by both MTOs and public authorities if they are to be implemented effectively, are designed to assist countries that want to improve the market for remittance services.

The complexity and variety of MTOs business models have evolved extensively over the past few years and, consequently, so have their supervision regimes. More and more countries have adopted single licensing regimes for all categories of payment service providers. For instance, in the EU, traditional money remitters are licensed under the payment institutions regime, and many countries have copied this regime (for example, Brazil, Jordan, Morocco, Tunisia, and so forth). Money remitters that offer e-money accounts are regulated as e-money-issuers in the EU and similarly in other countries. Therefore, legal regimes and associated AML/CFT requirements vary, depending on the business model, and supervisory arrangements also vary accordingly. In an increasing number of countries, payment systems overseers are also licensing MTOs or supervising MTOs, sometimes in cooperation with AML/CFT supervisors.

In any case, regulating and supervising MTOs or having a separate regulation for remittances could create a safe and sound remittance market and prove beneficial in reducing some of the costs of complying with legal requirements. In addition, it could change the perception of the industry. The World Bank's 2014 book *Making Remittances Work* provides a tip sheet with a step-by-step framework for national regulators and supervisors to implement an effective regulatory and supervisory regime for RSPs.⁴⁷ Such a regime should at least feature the following: (a) a better understanding of the remittance market by supervisors; (b) entry controls, risk-based supervision, and adequate cooperation between supervisors, including between AML/CFT supervisors, payment systems overseers, and the banks' supervisor; (c) proportionate and deterrent sanctions in the case of noncompliance or illegal provision of services; and (d) guidance provided by regulators and supervisors on what is expected from MTOs in AML/CFT compliance and what is expected from banks when providing banking services to MTOs. Figure 2 shows the steps for regulating and supervising remittance markets.

Also, a core objective of supervising and regulating remittances is preventing money laundering and terrorist financing. MTOs have been derisked because of the combination of cash-intensive businesses and perceived poor AML/CFT internal procedures. As a result, it could be beneficial to subject MTOs to AML/CFT requirements, which may include (a) licensing or registration,⁴⁸ (b) CDD, (c) record keeping, (d) the ability to trace transactions, (e) reports of suspicious activities, and (f) internal control systems as set out by FATF. Also, an industry code of conduct with independent certification could help, if AML/CFT regulators can support this process and banks can get some degree of comfort from the regulators about the implications of certification. Issuing domestic guidance, closely following specific FATF recommendations such as the "Guidance on Correspondent Banking Services" would also help, as it may contribute to clarifying regulatory expectations for MTOs.⁴⁹ In addition, focused training, in particular, for smaller MTOs could assist in improving their capacity to implement the guidance.

Figure 2. Summary of steps for regulating and supervising remittance markets



4.2 The role of the private sector

Contingency planning

Senior management of banks whose CBRs have been terminated should include derisking in banks' contingency plan. The loss of CBRs can have a negative effect not only on a bank's customers but also on the bank itself, as previously discussed. Moreover, rating agencies have also

started to factor in CBR termination as a reason for downgrading financial institution ratings. Therefore, possible derisking should prompt a bank's senior managers to remain vigilant to relationships with their correspondents and to include the "derisking risk" in their risk management and recovery plans. CBRs should be monitored at all times and any withdrawal should be reported immediately to management. Banks should also offer guidance in their contingency plan on how the businesses

should carry on if sudden and massive derisking occurs, and banks should develop a strategy to establish new CBRs.

The importance of reaching out to the correspondent banks and the role of professional associations

Respondents should also promptly react and be persistent whenever they face a termination of their CBRs. In one country, a respondent bank's practice showed the value of taking immediate action after being notified by the global bank of its intention to terminate the relationship. It immediately insisted on a person-to-person meeting with senior management of its correspondent bank at its U.K. headquarters; the respondent succeeded in extending the original notice of 30 days to 1 year. They agreed on an action plan. While the ultimate reasons for the correspondent bank's decision to extend the period cannot be verified, the respondents mentioned that they would consider taking the case to court, pointing out the low risk of its customer base (predominantly pensioners receiving state pensions from U.K. government). Prompt action and the threat of publicity may have played a role in that decision, too. Another financial entity experiencing the same problem followed a similar approach.

Bank and MTO associations can and should play a more active role by reaching out to global banks. In one country, different industry associations (of bank remittance officers and of correspondent banks) organize regular events with foreign participation to show their advances in complying with AML/CFT obligations and the improvements in the country's regulatory framework. These forums also serve as a good platform for the officers to discuss their interactions with foreign banks. Sharing mutual concerns and knowing how the industry is dealing with challenges is valuable intelligence to the correspondent bank industry. In one country, an association was established uniting all those dealing with correspondent banking services in one association. This way of building relationships may deserve consideration in other jurisdictions. One

bank indicated that their chief compliance officer's extensive experience in a large U.S. bank was instrumental to its maintaining a strong relationship with that bank. It allowed the respondent bank to adopt a risk-based framework very similar in design to the U.S. bank's risk framework, and the personal relationship helped ensure a degree of trust.

Implementing a risk-based approach as a prerequisite for refusing or terminating a CBR

Banks should follow a risk-based approach to terminating a CBR and always be able to objectively explain why the relationship is being terminated. Terminating a CBR is a business decision that can have serious implications for respondents. Many institutions complained about losing their accounts at short notice without getting any explanation from their correspondents. Going forward, an explicit provision on the notice period for termination should be included in the contractual arrangement between respondent and correspondent. As emphasised by the FATF, "the wholesale cutting loose of entire classes of customer, without taking into account, seriously and comprehensively, their level of risk or risk mitigation measures for individual customers within a particular sector is not in line with FATF standards."⁵⁰

The case of MTOs is particularly relevant; even though considered high risk, MTOs have very rarely resulted in banks having to pay significant fines. In a recent report by the Australian Financial Intelligence Unit on remittance corridors between Australia and Pacific Island countries, there is a clear and explicit statement that the corridor does not pose an ML/TF risk, contrary to what is often said. In the EU, a risk-based approach is becoming a legal obligation to deny access to banks' payment accounts services. Such an obligation forces banks to perform a risk-based analysis of each one of its clients and prevents them from closing the accounts without sufficient justification.⁵¹ This legal obligation will not prevent derisking from happening but it should make it much more difficult

to derisk as it will require duly motivated reasons to be evaluated by national supervisors. Implementing this approach will require a process to evaluate the reasons of the banks and the answers of the MTOs.

4.3 The potential of Fintech to address the derisking problem

Financial technologies have a great potential for lowering the cost of compliance, reducing the use of cash, increasing monitoring, and boosting confidence of correspondent banks in national systems. Currently, the financial sector is undergoing a major transformation brought about by the rapid development and spread of new technologies. The confluence of finance and technology is referred to as Fintech, typically describing companies or innovations that employ new technologies such as distributed ledger technologies.⁵² While Fintech is still evolving, it remains very promising as it offers many applications, including solutions to derisking. Those solutions can be broadly divided into three areas or groups:

- Simplifying and automating existing procedures
- Leveraging previously unavailable economies of scale

- Creating alternative plans to the existing correspondent banking framework

The first group comprises e-KYC and transaction monitoring measures.⁵³ These allow for automation of activities that were previously done manually by compliance staff, such as examination of documents, triaging of suspicious transactions, or cross-checking customer profiles with other databases such as sanctions lists, ID databases (see box 3), or credit information bureaus. One of the most promising areas where technology can add value is leveraging machine learning and other big data algorithms in transaction monitoring and due diligence procedures. Traditionally, transaction monitoring involves screening customers' operations on the basis of a set of defined rules, such as compliance with international sanctions lists or not exceeding preapproved transactions threshold. Solutions that are based on machine learning, however, can generate suspicious activity reports by automatically detecting patterns correlating with suspected fraud that could be difficult to produce for a human operator. This way, machine learning can (a) free up compliance departments' staff time and allow staff to focus on more thorough investigation of more complicated cases and (b) enable financial institutions to flag

Box 3. e-KYC: The case of India

India has come a long way in lowering the costs for KYC using electronic means. India is not included among the countries surveyed for this report, however, it provides a useful example. It uses the Aadhar system for identifying customers as the basis for its KYC efforts. Aadhar is a unique 12-digit identification number issued by the Indian government to every citizen. The idea behind Aadhar is to have a single, unique identification number on a document, the Aadhar card, that captures all details, including demographic and biometric information, of every individual resident in India. The Aadhar card does not replace existing ID documents, but it can be used to serve as the basis for compliance with KYC norms by financial institutions and other businesses that maintain customer profiles.

A resident Indian can apply for the Aadhar number and card by submitting the existing proof of identity (passport, driving license, and so forth) and proof of address (phone, power bill, bank statements, and so forth) and by undergoing biometric profiling (fingerprints and iris scan) at any Aadhar center.

For correspondent banks, the knowledge that its respondents use a biometric ID system and have access to reliable and up-to-date information on their customers gives them a degree of comfort regarding KYC by their respondents and thus, all other things being equal, makes this relationship more attractive.

and triage activities that would otherwise remain undetected. However, the effectiveness of big data in transaction monitoring and due diligence, to a great extent, depends on certain preconditions. First, leveraging technology solutions would require a coordinated action between financial institutions and central banks or other regulators.⁵⁴ Second, the staff must have the capacity to understand and use the results from the algorithms effectively. This capacity is considered a major challenge. Technological solutions are often viewed as black boxes, with bank employees lacking in understanding of the underlying algorithms and in the ability to tailor them to local needs and contexts.

The second group includes automating compliance measures that allow for new economies of scale, created by sharing information across different financial institutions through KYC utilities. The term KYC utility is used to cover an extensive array of different information-

supply mechanisms, but the essence of it is that banks do not have to gather KYC information on a particular customer themselves. Instead, they have recourse to a utility, typically a database, that has certain information available on that customer. This information is particularly relevant in the context of correspondent banking.⁵⁵ However, regulatory backing will be necessary to foster wider adoption. In particular, financial institutions must be certain that they will not be penalized for accepting trusted KYC profiles from the database and that other parties maintain similarly rigorous due diligence standards.⁵⁶ (See box 4 on KYC utilities). Further, privacy laws may also prohibit sharing, storing, or mining basic information in KYC utilities, such as other correspondent relationships and details of geographical areas served.⁵⁷

Other cases of KYC utilities are being developed in other jurisdictions or by international bodies as discussed in box 5.



Box 4. KYC utilities: The case of Mexico

KYC utilities vary in the extent of the information they provide, with some having barely more than a name and an address, whereas others have more extensive information, sometimes even including the financial behavior of the client. In addition, the utilities vary according to how they are put together—by an independent third party, by government, or by financial institution—and to how the integrity of the stored data is secured.

Mexican authorities are developing two databases that will be combined: a database for cross-border transactions and a KYC utility. The database for cross-border transactions records all domestic wire transfers in foreign currency, as well as cross-border wire transfers originating in Mexico, irrespective of their size. Every financial transaction that crosses the border has to be reported. For each transaction, banks report basic information about the ordering customer, the recipient bank, the beneficiary of the transfer, the amount sent, the currency sent, and more. It is noteworthy that the database does not capture inbound operations that originate abroad at this point. Inbound transactions will be captured in late 2018.

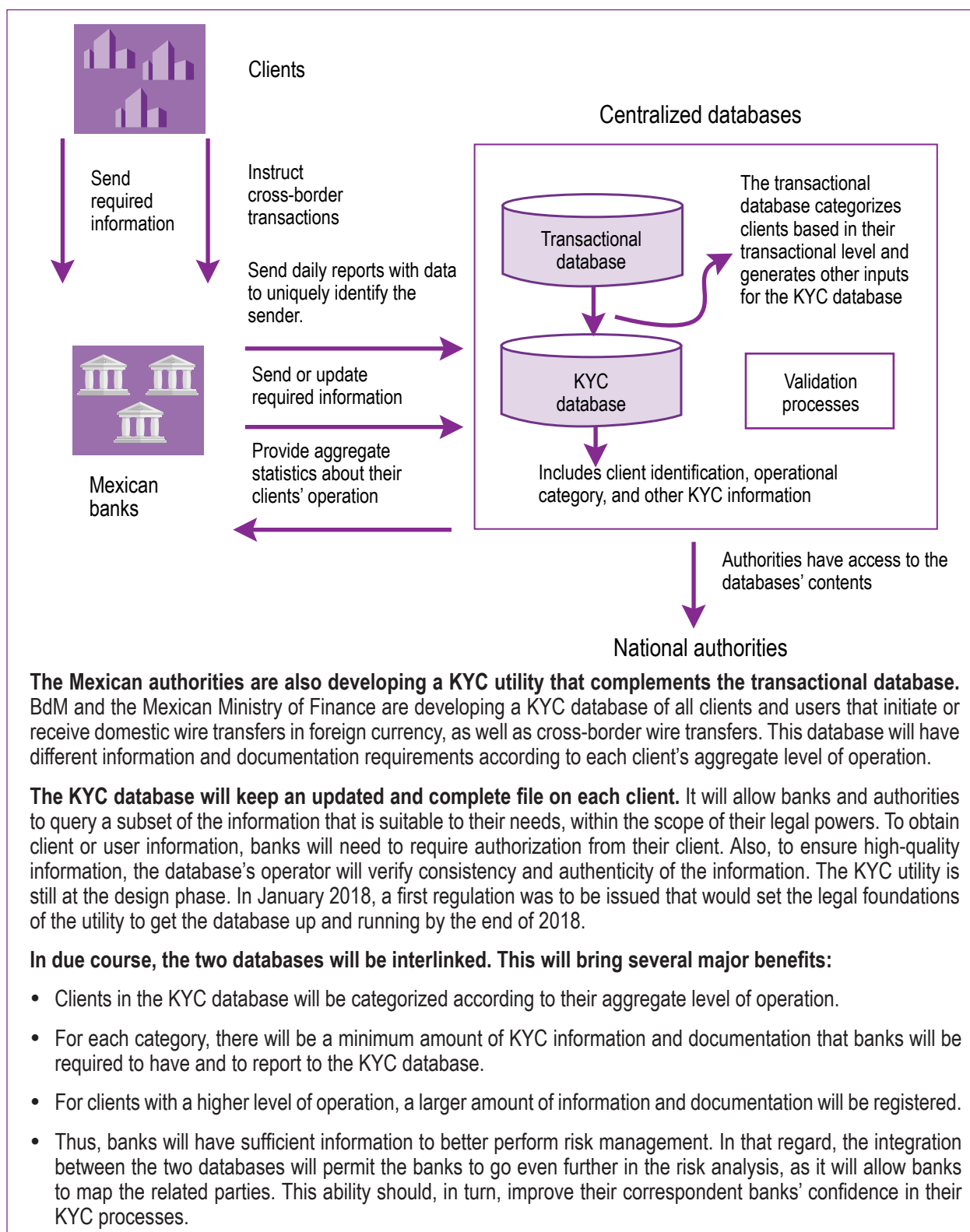
The goal of the database for cross-border transactions is to enable banks to assess the risk of their customers in a more holistic way. Banks only have a partial view on the financial profile of their customers. They have information on the transactions which they conduct on behalf of their clients but not on those transactions conducted by other entities. Through the database, each bank can see the forest—not only the trees.

The output can be queried at any time by the banks, and will comprise information on a customer's transactions from the previous year, which will be updated daily. Although no other information needs to be gathered by the banks, the database will foster the quality of ML/FT risk management by providing additional information on transactions that are not accessible otherwise. In addition, the database provides detailed information on cross-border transactions and domestic wire transfers in foreign currency. The system also defines for each client a specific code (ranging from 1 to 5) corresponding to the client's level of activity, which should lead the bank to conduct extra due diligence and seek more information on the client.

Accuracy and consistency of data are of paramount importance. For the database to accurately summarize the transactional activity of a sender in the financial system and to gain trust among banks as a reliable source of information, reported data must be high quality. Therefore, Banco de Mexico (BdM) established a comprehensive framework to encourage banks to report consistent and authentic data combined with measures to rectify already reported data and to avoid recurrences.

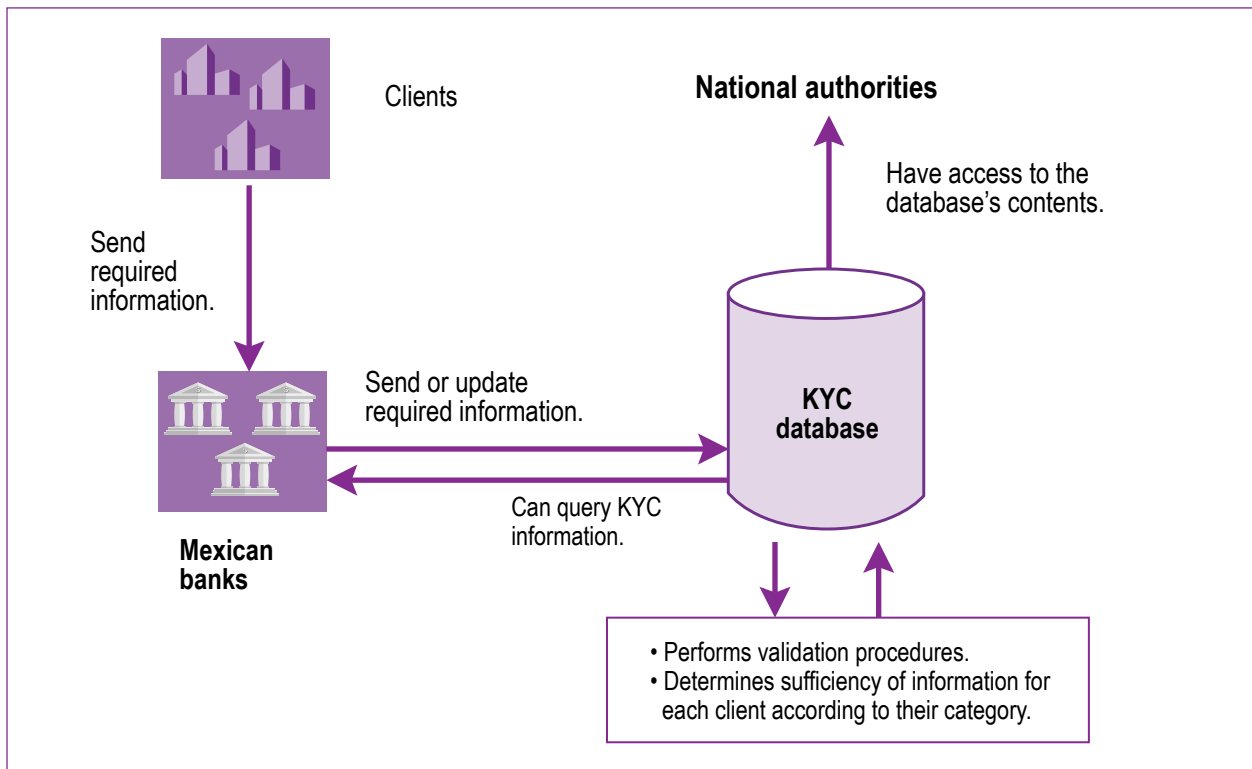
The database, although not yet operational, has a wide scope, is resource intensive, and relies on a proper information technology infrastructure. Whereas the usefulness of a database with these dimensions is clear, however, this database may not be an option for low-capacity countries. The database design and implementation have been resource intensive.⁵⁸ Furthermore, there are some preconditions to be met, including a reliable and widely distributed information technology infrastructure, sufficient capacity to maintain the system (BdM developed an in-house algorithm to monitor inconsistencies and errors), and strong security systems to protect against cyber threats.

Figure 3. The database architecture

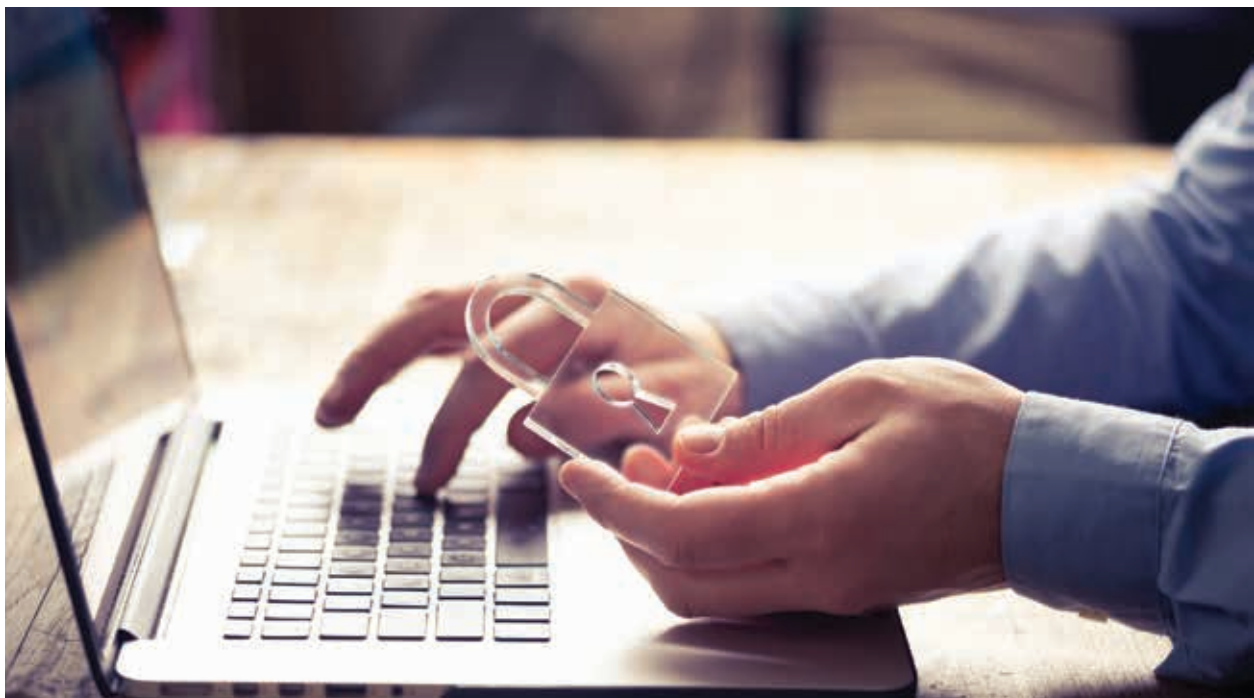


Source: Banco de México

Figure 4. The KYC utility architecture



Source: Banco de México



Box 5. The case of Singapore

Singapore (not included among the countries surveyed for this report) also has developed a KYC utility as a way to enhance customers' onboarding. According to the Monetary Authority of Singapore (MAS), KYC is one of the most complex processes in the financial industry because it is costly, laborious, redundant, and still not fully effective in detecting tax evasion or money laundering.⁵⁹ The government has taken the first step with MyInfo—a single platform containing personal data submitted to and verified by the government. MAS and the Government Technology Agency of Singapore have conducted a pilot program with several banks to enable customers to open a bank account online using MyInfo. Application timings were shortened by as much as 80 percent in the pilot.

Going forward, MAS is working closely with local and foreign banks to explore a banking KYC shared-services utility that will streamline KYC. This streamlining means centralizing processes such as (a) leveraging on MyInfo for customer identification and verification, (b) collecting and validating KYC documents, and (c) screening against sanctions and blacklists. The banking KYC utility expected to be in place in 2018 will (a) harmonize and enhance KYC checks across the industry and (b) improve the quality of risk management while reducing cost and time taken.

The SWIFT KYC registry

As indicated by SWIFT, more than 1.3 million bilateral correspondent relationships exist across the industry. This amount of data creates a massive administrative burden for banks each time a relationship is added or information needs updating. Yet it has never been more important to ensure that due diligence on banks' correspondents and their downstream relationships is thorough, timely, and accurate.

In December 2014, SWIFT launched a KYC registry that meets the need for an efficient, shared platform for managing and exchanging standardized KYC data.⁶⁰ SWIFT has worked with the world's largest correspondent banks to define a set of data and documentation that addresses KYC requirements across multiple jurisdictions. Limited to SWIFT-connected supervised institutions when the registry was started, in December 2017 SWIFT opened access to all supervised financial institutions, regardless of whether they are connected to SWIFT.

According to SWIFT, the KYC registry is a "secure, global utility which nearly 4,000 correspondent banks and funds players use to contribute, share and consume a comprehensive set of KYC data and documents. The Registry helps financial institutions streamline the exchange of know your customer information to support KYC compliance. Member institutions share their data in response to access requests from their counterparties who 'consume' the data as part of their KYC processes. Each institution retains ownership of its Registry data, and full control over which counterparties can access it."⁶¹

Thomson Reuters's central registry for bank client data

In 2014, Thomson Reuters launched Accelus Org ID, a central KYC platform to help leading banks and investment managers make informed KYC and onboarding decisions while creating a more sustainable and compliant regulatory environment for themselves and their clients. The registry acts as a central clearing house for banks, corporations, asset managers, hedge funds, and others to check identity documentation for their counterparties. The proposed solution brings several benefits to the users, such as reducing onboarding time and cost as well as enhancing regulatory compliance.⁶² In particular, the platform provides a comprehensive risk-based KYC policy that has been stress tested with regulators and more than 100 financial institutions globally, as well as information on ultimate beneficial owners. As indicated by Thomson Reuters, the registry is the only service to provide integrated ongoing screening and monitoring to detect changes in bank's customers' KYC profiles.

The third group of Fintech approaches to the derisking issue consists of attempts to redefine the existing correspondent banking architecture, often by using “cryptocurrencies” as “bridge assets.” In this framework, financial institutions maintain liquidity only in local currency and the bridge asset, with cross-border settlements occurring in that bridge asset. A number of different bridge assets have been proposed, from bitcoin and ether to product-specific cryptocurrencies such as XRP (promoted by Ripple) or Lumens (promoted by Stellar). Such efforts need to be treated, however, with caution. The viability of using cryptocurrencies to facilitate cross-border transfer will depend on the availability to convert cryptocurrencies and local

currency at will. It is not clear whether markets most affected by derisking are likely to sustain the required number of exchanges. Moreover, the high volatility of cryptocurrency exchange rates introduces additional market risks that would need to be managed. Finally, cryptocurrency exchanges are increasingly facing the same AML/CFT requirements as traditional financial institutions. In some cases, those requirements are even more stringent considering that in many jurisdictions cryptocurrencies are associated with illicit financial flows. As a result, their long-term suitability as alternatives to the traditional correspondent banking model has not yet been proven.

Box 6. Examples of alternative solutions to correspondent banking

Ripple. The model focuses on commercial cross-border and interbank payments combined with cross-currency funds settlement. Ripple allows for a move away from establishing upfront correspondent banking relationships toward a more dynamic approach. This approach identifies a path for the flow of funds from a sender in a particular currency to a receiver in a particular currency, through a series of participating institutions that offer services for that currency. This method can lead to better discovery of prices for foreign exchange transactions and to expanding access to such services for smaller remittances companies. Ripple’s own cryptocurrency, XRP, is actively traded on several cryptocurrency exchanges. Ripple also operates its own exchange, structured as a network described previously, in which the top currencies actively exchanged are CNY, USD, JPY, and EUR. In addition, other cryptocurrencies like bitcoin and ether are also actively exchanged.

Abra. This model offers instant peer-to-peer money transfers with no transaction fees through Abra’s network, combining cryptocurrency with physical bank tellers. Because of the existence of tellers, bank accounts are not required to conduct a cross-border payment; only the recipient’s phone number is required. As of 2017, Abra is available globally and supports more than 50 currencies in addition to bitcoin.

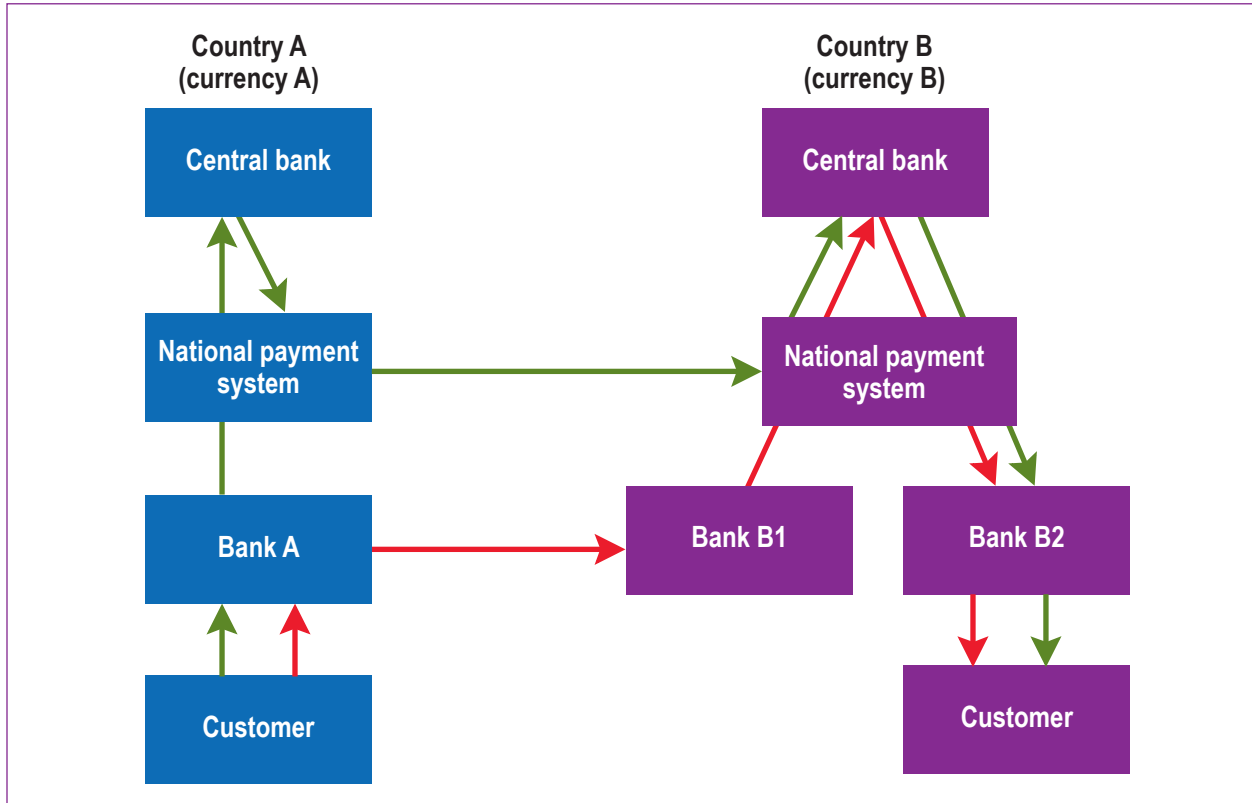
Note: See World Bank, “Distributed Ledger Technology (DLT) and Blockchain,” Fintech Note 1, World Bank, Finance & Markets Global Practice, Washington, DC, 2017, <http://documents.worldbank.org/curated/en/177911513714062215/pdf/122140-WP-PUBLIC-Distributed-Ledger-Technology-and-Blockchain-Fintech-Notes.pdf>.

Another substitute to correspondent banking—not Fintech based—is creating a direct link between the central banks payments systems themselves.⁶³ The current method of executing a cross-border transaction through correspondent banking is shown in figure 4 in red arrows. Where Bank A settlement flows reach Country B through its CBR, it enters the national payment system to reach the end customer. The green arrows depict the process using a direct link between the national payment systems and therefore circumventing Bank A’s correspondent bank. As addressed in the General Principles of International Remittances, this solution comes with several barriers including standardization of message formats, exchange rate agreements, and proper settlement arrangements.⁶⁴ Addressing these issues is difficult and may be costly. Additionally, integration of cross-jurisdiction systems may require a high degree of

multilateral collaboration and involvement from a variety of industry players from both countries including regulators, payments system operators, and RSPs, just to name a few. However, because of the potential benefits and the current state of derisking in the world, this alternative may be worth evaluating again.

The proposed Fintech solutions discussed have not been tried and tested so far and thus are still in the concept phase. It is not clear if each solution would always comply with AML/CFT standards and allow for full transparency from payment senders to recipients. Also, to the extent that some of the solutions allow for the direct access to information across borders, it may be necessary to make amendments to laws (notably on data privacy). All technology is vulnerable to exploitation by bad actors and therefore requires adequate cyber-risk safeguards.

Figure 5. Current and alternative settlement flows



Note: red arrows = settlement flows for current method of making cross-border payments via correspondent banking relationship; green arrows = settlement flows for the payment system’s direct link alternative.

The development of other innovative products and alternative options to correspondent banking

Other cases of innovation do not rely on correspondent banking such as digital remittance products. As discussed previously, closures of MTOs have caused (a) reduction in competition for domestic remittance markets, (b) greater vulnerability of countries to disruptions in the flow of much needed remittances, and (c) movement of local remittances into informal channels. The development of digital products provides a promising solution to this problem. Ave Pa'Anga Pau, a digital voucher designed in Tonga, does not rely on correspondent banking relationships and has a high degree of automated AML/CFT compliance. It is purchased online through the internet or mobile devices. No cash is accepted. All remittance senders and receivers are subject to AML/CFT screening when they register. The voucher is a retail product, and this designation is reflected in the design limits imposed on the amount of remittances that individuals can transact: a maximum of New Zealand dollars (NZD) 1,000 (~USD 730) per day and a cumulative maximum of

NZD 10,000 (~USD 7,300) per year. Transactions are monitored in real time with an automated AML/CFT reporting system. NZD are paid into the New Zealand bank account in the name of the Tonga Development Bank (TDB) held at KiwiBank. These funds cumulate in the New Zealand account and are used to settle Tongan import payments. In Tonga, the importers of these goods and services pay Pa'Anga to TDB which, in turn, provides the required Pa'Anga to the remittance beneficiaries. The funds can either be withdrawn from a bank account in Tonga or paid as cash through a TDB representation point on production of a unique code (transmitted to mobile phones) and face-to-face identification. The transactions occur entirely within the banking system, are fully transparent, and are subject to regulatory oversight in New Zealand and Tonga.⁶⁵ The product was launched in early 2017 and by June 30 more than NZD 1 million had been remitted with volumes doubling month on month. The product development was supported by IFC and was aimed at demonstrating that it is possible to deliver a compliant remittance solution within the existing regulatory framework. It also strengthens the formal remittance channel between New Zealand and Tonga.⁶⁶



CURRENTLY EXCHANGE RATES

USD	1.3100	▲
EUR	0.9090	▼
GBP	1.667X	▲
JPY	0.1622	▼
AUD	0.8220	▼
CAD	0.8258	▲

CONCLUSION

This survey confirms what has already been signaled in previous general publications and work undertaken by international bodies including the IMF, FSB, WB, IFC, and IDB—in particular, that payment flows are being concentrated through fewer channels and that global banks are being replaced by second-tier banks as correspondent banking providers. The survey also supports the thesis that derisking has not led to significant macroeconomic impacts. Both business considerations and AML/CFT concerns have also clearly come out as the primary cause for terminating or restricting CBRs.

This survey also suggests that the MTOs have been adversely affected by the closure of their accounts by banks. The extent to which these effects are having cascading effects on the flows and costs of remittances is still unclear and further work is needed.

Several solutions are being implemented by countries, including developing KYC registries that could reduce the cost of compliance and increase the trust of correspondent banks in the quality of their respondents' AML/CFT processes. By allowing greater transparency, traceability, and auditability, Fintech are also promising solutions that can revolutionize the way banks apply and comply with AML/CFT standards. In that regard, collaboration between banks, regulators, and Fintech companies should be continued, keeping in mind that these solutions also come with their own risks.

Regulators and supervisors have an important role to play, too. Enhancing AML/CFT regimes is an essential part of the solution to derisking. Establishing ways to monitor trends in correspondent banking relationships is also warranted, especially by collecting and analyzing bank-by-bank data on a country level. This method can help authorities better understand existing vulnerabilities in their system and adopt appropriate action.

Last, there is no silver bullet to address the derisking problem. In banks' opinion, CBR remains a low-margin activity that carries high risk. No matter how detailed the discussion goes for the potentially perfect compliance of respondent banks and MTOs, the final answer is that derisking is a business decision.



ENDNOTES

1. World Bank, “Withdrawal from Correspondent Banking Where, Why, and What to Do about It,” International Bank for Reconstruction and Development and the World Bank Group, Washington, DC, November 2015, <http://documents.worldbank.org/curated/en/113021467990964789/pdf/101098-revised-PUBLIC-CBR-Report-November-2015.pdf>.
2. The Wolfsberg Group, “Wolfsberg Anti-Money Laundering Principles for Correspondent Banking,” Wolfsberg Group, 2014, p. 1, <https://www.wolfsberg-principles.com/sites/default/files/wb/pdfs/wolfsberg-standards/8.%20Wolfsberg-Correspondent-Banking-Principles-2014.pdf>.
3. The international community, led by the World Bank, started working on reducing the cost of sending money home in 2005. As of October 2015, these efforts were estimated to have saved migrants and their families up to USD 62.5 billion, according to the Remittance Prices Worldwide database.
4. The World Bank Group, “Fact Finding Summary from De-Risking Surveys: Withdrawal from Correspondent Banking and Report to the G20 Survey on De-Risking Activities in the Remittance Market,” International Bank for Reconstruction and Development and the World Bank Group, Washington, DC, 2015, <http://documents.worldbank.org/curated/en/2015/11/25481336/fact-finding-summary-derisking-surveys>.
5. Financial Stability Board, “Report to the G20 on Actions taken to Assess and Address the Decline in Correspondent Banking,” Financial Stability Board, Basel, Switzerland, November 6, 2015, <http://www.fsb.org/wp-content/uploads/Correspondent-banking-report-to-G20-Summit.pdf>.
6. Ibid.
7. Bank for International Settlements (BIS), “Correspondent Banking,” BIS, Basel, Switzerland, July 2016, <http://www.bis.org/cpmi/publ/d147.pdf>; International Monetary Fund (IMF), June 2016. The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action, IMF Staff Discussion Note, IMF, Washington, DC, June 2016, <https://www.imf.org/external/pubs/ft/sdn/2016/sdn1606.pdf>; The Commonwealth, *Disconnecting from Global Finance: De-Risking—The Impact of AML/CFT Regulations in Commonwealth Developing Countries*, Commonwealth Secretariat, London, 2016, <http://thecommonwealth.org/disconnecting-from-global-finance>; Charity Finance Group, “Briefing: Impact of Banks’ De-Risking on Not for Profit Organisations,” Charity Finance Group, London, 2015, http://www.cfg.org.uk/Policy/~/_/media/Files/Policy/Banking/Briefing%20Impact%20of%20banks%20derisking%20activities%20on%20charities%20March%202015.pdf.
8. Financial Stability Board, “FSB Correspondent Banking Data Report,” FSB, Basel, Switzerland, 2017, <http://www.fsb.org/2017/07/fsb-correspondent-banking-data-report/>.

9. International Monetary Fund (IMF), “Recent Trends in Correspondent Banking Relationships: Further Considerations,” IMF, Washington, DC, April 21, 2017, <https://www.imf.org/en/Publications/Policy-Papers/Issues/2017/04/21/recent-trends-in-correspondent-banking-relationships-further-considerations>.
10. World Bank, “De-Risking and Other Challenges in the Emerging Market Financial Sector: Findings from IFC’s Survey on Correspondent Banking,” Working Paper, World Bank, Washington, DC, 2017, <http://documents.worldbank.org/curated/en/895821510730571841/De-risking-and-other-challenges-in-the-emerging-market-financial-sector-findings-from-IFC-s-survey-on-correspondent-banking>.
11. Mexico gave its explicit consent to disclose any information relating to its KYC utility. Angola was not part of the eight countries surveyed but agreed to discuss derisking issues during conference calls. Other information related to countries explicitly mentioned in the survey is in the public domain.
12. Dirk Jan Grolleman and David Jutra, “Understanding Correspondent Banking Trends: A Monitoring Framework,” IMF Working Paper 17/216, International Monetary Fund, Washington, DC, 2017, <https://www.imf.org/~media/Files/Publications/WP/2017/wp17216.ashx>.
13. This country was included in the studies because the banking services that its banks provided in the region to other respondents were affected.
14. Relationship management application (RMA) is a service provided by SWIFT to manage the business relationships between financial institutions. RMA operates by managing which message types are permitted to be exchanged between users of a SWIFT service. The receiver specifies which message types are permitted and sends this permission data to the sender; the sender checks the message type against the permission data before sending a message to the receiver.
15. World Bank Group, “Withdraw from Correspondent Banking: Where, Why, and What to Do about It,” Working Paper 101098, World Bank, Washington, DC, 2015, <http://documents.worldbank.org/curated/en/113021467990964789/Withdraw-from-correspondent-banking-where-why-and-what-to-do-about-it>.
16. In most if not all cases, banks do not disclose why the decision was made to terminate the relationship.
17. Note that correspondent banking is a low-margin business.
18. In one country, recent allegations of illicit acts committed by senior managers and directors of prominent banks seem to have played a key role in the withdrawal of correspondent banks.
19. There were also cases where the termination was done without notice.
20. Regional banks that had been operating for many years in the Southern Africa Development Community stopped supplying USD in Angola and Zimbabwe at the request of U.S. banks.
21. In a credit opinion dated June 28, 2016, one of the rating agencies decided to “downgrade [Bank X’s] ratings and placed them on review for downgrade, reflecting the bank’s loss of all of its correspondent banking lines which if not addressed in a timely manner could potentially prevent the bank from paying the November 2016 coupon of “XXX’s” global bond. The review will focus on [Bank X’s] ability to secure new stable and reasonably priced correspondent banking lines in a timely

- manner. We will also reassess the probability that the bank will benefit from public support with a focus on any measures [Country X]’s Superintendency of Banks and central bank may take to help ensure the bank’s ability to repay foreign bondholders despite the loss of its correspondent lines.”
22. These onsite assessments are the occasion to enquire about the general political and economic context, cases of corruptions, and the bank’s AML/CFT monitoring system.
 23. FATF recommendations do not require the correspondent bank to know its customer’s customers (KYCC). In other words, correspondent banks are not required to conduct CDD on the individual customers of its respondent institution; see Financial Action Task Force, “FATF Guidance on Correspondent Banking Services,” FATF, Paris, 2016, <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-Correspondent-Banking-Services.pdf>.
 24. SWIFT estimates that for large banks the due diligence cost for high-risk counterparts can reach as much as \$50,000 per year. See SWIFT, “Addressing the Unintended Consequences of De-Risking—Focus on Africa,” information paper, SWIFT, La Hulpe, Belgium, August 2016, file:///C:/Users/Owner/Downloads/swift_info_paper_derisking_africa_focused_0.pdf.
 25. World Bank, “Remittances to Rec over Modestly after Two Years of Decline,” press release, World Bank, Washington, DC, October 3, 2017, <http://www.worldbank.org/en/news/press-release/2017/10/03/remittances-to-recover-modestly-after-two-years-of-decline>.
 26. The International MTO Index tracks the prices of MTOs that are present in at least 85 percent of corridors covered in the RPW database; see also World Bank, Remittance Prices Worldwide 22 (June 2017), https://remittanceprices.worldbank.org/sites/default/files/rpw_report_june_2017.pdf.
 27. World Bank, “De-Risking in the Financial Sector,” Brief, World Bank, Washington, DC, October 2016, <http://www.worldbank.org/en/topic/financialsector/brief/de-risking-in-the-financial-sector>.
 28. Carlo Corazza, “The World Bank’s Data Gathering Efforts: De-Risking: Key Findings and Recommendations,” presentation, World Bank, Washington, DC, January 2016, <http://pubdocs.worldbank.org/en/953551457638381169/remittances-GRWG-Corazza-De-risking-Presentation-Jan2016.pdf>.
 29. Susan Starnes, Michael Kurdyia, Arun Prakash, Ariane Volk, and Shengnan Wang, “De-Risking and Other Challenges in the Emerging Market Financial Sector: Findings from IFC’s Survey on Correspondent Banking,” *IFC Insights*, September 1, 2017, <https://www.ifc.org/wps/wcm/connect/3d215edb-55da-4097-982c-e90409d6621a/IFC+2017+Survey+on+Correspondent+Banking+in+EMs+final+September+1.pdf?MOD=AJPERES>.
 30. Agnès Joly, “De-Risking In Trade Finance—Time to Act,” *Insights, Société Générale*, October 17, 2017, <https://www.securities-services.societegenerale.com/en/insights/banking/risking-trade-finance-time-act/>.
 31. SWIFT’s RMA enables financial institutions to define which counterparties can send them SWIFT FIN messages and blocks unwanted message traffic at the sender, providing a first line of defense against fraudulent transactions.
 32. That percentage is higher than the global average of 32 percent, according to SWIFT data, 2014.

33. World Bank, *Remittance Price Worldwide*, 24 (December 2017), https://remittanceprices.worldbank.org/sites/default/files/rpw_report_december2017.pdf.
34. See, for example, France-Comoros 4.98 percent. World Bank, *Remittance Prices Worldwide Database*.
35. Sue E. Eckert, Kay Guinane, and Andrea Hall, “Financial Access for U.S. Nonprofits,” The Charity and Security Network, Washington, DC, February 2017, <https://www.charityandsecurity.org/FinAccessReport>; Duke Law International Human Rights Clinic and Women Peacemakers Program, *Tightening the Purse Strings: What Countering Terrorism Financing Costs Gender Equality and Security* (Durham, NC: Duke Law International Human Rights Clinic and Women Peacemakers Program, 2017), <https://law.duke.edu/humanrights/tighteningthepursestrings/>; Tom Keatinge and Florence Keen, *Humanitarian Action and Non-State Armed Groups: The Impact of Banking Restrictions on UK NGOs* (London: Chatham House, 2017), <https://www.chathamhouse.org/publication/humanitarian-action-and-non-state-armed-groups-impact-banking-restrictions-uk-ngos>; and Mayada El-Zoghbi, Nadine Chehade, Peter McConaghy, and Matthew Soursourian, “The Role of Financial Services in Humanitarian Crises,” Consultative Group to Assist the Poor, Washington, DC, April 24, 2017, <http://www.cgap.org/publications/role-financial-services-humanitarian-crises>. Additional empirical studies are under way by the Human Security Collective and the Charity Finance Group.
36. Eckert, Guinane, and Hall, “Financial Access for U.S. Nonprofits.”
37. Despite the efforts to reduce the level of dollarization in the domestic banking system, Angola will continue to rely heavily on correspondent banks for international transactions. See Global Credit Research, “Angolan Banks FAQ Answers Investors’ Questions on Correspondent Banking Pullback,” *Moody’s Investors Service*, August 9, 2017, https://www.moody’s.com/research/Moodys-Angolan-Banks-FAQ-answers-investors-questions-on-correspondent-banking--PR_370994.
38. Moody’s, 2017.
39. International Monetary Fund (IMF), “Recent Trends in Correspondent Banking Relationships—Further Considerations,” IMF, Washington, DC, March 16, 2017, <https://www.imf.org/~media/Files/Publications/PP/031617.ashx>; IMF, “The Withdrawal of Correspondent Banking Relationships.”
40. The MTOs have raised the issues of derisking with authorities over several years and have received the backing of both the central bank and the government in a number of regional meetings. However, to date these interventions have had little effect.
41. One prominent bank in this country that represents the biggest market share of remittances lost 25 nostro accounts, but it opened 27 new CBRs with correspondent banks from UAE and India.
42. In September 2017, New York’s state banking regulator imposed a USD 225 million fine on Habib Bank, the biggest bank in Pakistan, and ordered it out of the United States after finding a long list of flaws in its compliance that opened the door to the financing of terror. See Ben McLannahan, “New York Regulator Kicks Pakistan’s Habib Bank Out of US,” *Financial Times*, September 7, 2017, <https://www.ft.com/content/7389b858-93e8-11e7-a9e6-11d2f0ebb7f0>.
43. There are 133 million mobile phone users in one of the surveyed countries, a ubiquitous network that reaches into all corners, and it is through this network that hundis service their

- customers. In overseas countries where the diaspora and workers from this country reside, money can be sent home by using a hundi. The advantages of using an illegal service outside of the banking system are several: (a) cash can be paid to the agent with no questions asked and no documentation required; (b) the exchange rate applied to the transaction is better than the one that can be obtained through the official, formal channels; and (c) the money can be accessed by beneficiaries at home within an hour. In short, the cost–benefit of the hundi system for the individual outweighs the fact that it is illegal for many users.
44. The IMF has developed a tool to understand and track CBRs trends. See Dirk Jan Grolleman and David Jutra, “Understanding Correspondent Banking Trends: A Monitoring Framework,” IMF Working Paper, International Monetary Fund, Washington, DC, October 4, 2017, <https://www.imf.org/en/Publications/WP/Issues/2017/10/04/Understanding-Correspondent-Banking-Trends-A-Monitoring-Framework-45318>.
 45. The International Organization for Standardization (IOS) promotes global standardization for specifications and requirements for materials, products, procedures, formats, information, and quality management.
 46. Massimo Cirasino, “The Committee on Payment and Settlement Systems and the World Bank General Principles on International Remittance Services,” World Bank, Washington, DC, <http://documents.worldbank.org/curated/en/975781468763485550/The-committee-on-payment-and-settlement-systems-and-the-World-Bank-general-principles-on-international-remittance-services>.
 47. Emiko Todoroki, Wameek Noor, Kuntay Celik, and Anoma Kulathunga, *Making Remittances Work: Balancing Financial Integrity and Inclusion* (Washington, DC: World Bank, 2014), <http://documents.worldbank.org/curated/en/134841468128111804/pdf/884820PUB0Box300EPI2101090May292014.pdf>.
 48. In broad terms, “registration” is where an RSP must identify itself to the authorities and provide certain information about itself and its service, with the authorities attaching few or no conditions to the ability of the provider to offer its service. “Licensing” is where substantive conditions are attached. In practice, the distinction between registration and licensing is sometimes blurred.
 49. Financial Action Task Force, Guidance on Correspondent Banking Services, FATF, Paris, October 2016, <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-Correspondent-Banking-Services.pdf>.
 50. Ibid.
 51. Under the Second Payment Services Directive (PSD2), all payment and RSPs that are registered under EU legislation should have access to banks’ payment accounts services unless there is an objectively justified reason to refuse such access. According to article 29a of the PSD, “Member States shall ensure that payment institutions have access to credit institutions’ payment accounts services on an objective, non-discriminatory and proportionate basis. Such access shall be extensive enough to allow payment institutions to provide payment services in an unhindered and efficient manner. The credit institution shall provide the competent authority with duly motivated reasons for any rejection.” In the same vein, Recital 27 of the PSD states: “Payment service providers when engaging in the provision of one or more of the payment services covered by this Directive should always hold payment accounts used exclusively for payment transactions. For payment service providers to be able to provide payment services, it is indispensable that they have the possibility to open and maintain

accounts with credit institutions. Member States should ensure that access to such accounts is provided in a non-discriminatory way and proportionately to the legitimate aim it intends to serve. While the access could be basic, it should always be extensive enough for the payment institution to be able to provide its services in an unobstructed and efficient way.” See https://ec.europa.eu/info/law/payment-services-psd-2-directive-eu-2015-2366_en.

52. Distributed ledger technology refers to a novel and fast-evolving approach to recording and sharing data across multiple data stores (or ledgers). This technology allows for transactions and data to be recorded, shared, and synchronized across a distributed network of different network participants. A blockchain is a particular type of data structure used in some distributed ledgers which stores and transmits data in packages called blocks that are connected to each other in a digital chain. Blockchains employ cryptographic and algorithmic methods to record and synchronize data across a network in an immutable manner. See World Bank, “Distributed Ledger Technology (DLT) and Blockchain,” Fintech Note 1, World Bank, Finance & Markets Global Practice, Washington, DC, 2017, <http://documents.worldbank.org/curated/en/177911513714062215/pdf/122140-WP-PUBLIC-Distributed-Ledger-Technology-and-Blockchain-Fintech-Notes.pdf>.
53. This first group also includes the SWIFT’s Global Payments Initiative (GPI), which attempts to improve the efficiency of the global correspondent banking system through providing up-to-date information about each leg of an international payment and each institution’s compliance with the GPI service-level agreement. In subsequent phases of GPI implementation, the consortium plans to use distributed ledger technology to help settlement and reconciliation of nostro accounts.
54. The Chief Data Office of the Monetary Authority of Singapore has named the following as the necessary components to support such data exchange processes: (a) availability of the data, (b) deployment of appropriate tools, (c) necessary technological infrastructure, and (d) training staff for the relevant skill sets.
55. A correspondent bank has access to readily available information on a respondent bank thereby decreasing significantly the time and cost that it would take to gather the information on its own. A correspondent’s knowledge that its respondent is using a reliable instrument to gather information on its clients may allay concerns about the strength of the respondent’s KYC measures and result in lower risk categorization or fewer sample checks to test the system and thus to lower costs.
56. There is an ongoing debate on the extent to which third parties (banks) would be able to rely on data in a KYC utility and whether they would be liable for any errors in data retrieved from a KYC utility. The prevailing view (as also expressed in FATF Rec 17) is that those who use information are ultimately responsible for its accuracy.
57. Bank for International Settlements (BIS), “Correspondent Banking,” Committee on Payments and Market Infrastructures, BIS, Basel, Switzerland, July 2016, <https://www.bis.org/cpmi/publ/d147.pdf>.
58. Twenty full-time staff members of the Bank of Mexico were assigned to this project for one year.
59. Remarks by Ravi Menon, managing director of the Monetary Authority of Singapore, at the Singapore FinTech Festival, Singapore, November 14, 2017.
60. See the KYC registry at www.swift.com/kycregistry.

61. See SWIFT, “SWIFT Extends KYC Registry Membership to All Supervised Financial Institutions,” news release, SWIFT, Brussels, July 17, 2017, <https://www.swift.com/news-events/press-releases/swift-extends-kyc-registry-membership-to-all-supervised-financial-institutions>.
62. See “KYC as a Service,” Thomson Reuters, <https://risk.thomsonreuters.com/en/products/kyc-as-a-service.html>.
63. Cirasino, “The Committee on Payment and Settlement Systems and the World Bank General Principles.”
64. Ibid.
65. Because the provider of the digital voucher is a bank, it has the liquidity to handle the pay out to beneficiaries.
66. Of course, this solution hinges on one bank having a presence in both sending and receiving jurisdictions allowing the banks to net the different accounts against each other. Where this ability is not the case, such a solution would not be a viable option.

