Written Testimony of Wendy Delmar

Chief Executive Officer, Caribbean Association of Banks Inc

House Committee on Financial Services

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

Wednesday 14 September 2022

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

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

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

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

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

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

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

Impact and Effects of De-risking

- Increased operational costs

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

- Perpetuation of shadow banking

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

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

- Reduced appetite for foreign direct investment

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

- Limited participation in international trade

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

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

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

<u>Strategies for Improvement</u>

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

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

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

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

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

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

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

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

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

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

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