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In Depth: Are Authorities Doing Enough To Fight De-Risking?

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Are influential regulators, international standards-setters and financial sector participants doing enough to tackle de-risking? PaymentsCompliance speaks to J. Andrew Spindler, a former New York Fed vice president and chief executive of the Financial Services Volunteer Corps (FSVC), about what authorities can do, and whether there is cause for hope.

For financial firms, not least those handling cross-border payments, access to the formal international financial system is a pre-requisite for doing business. However, across the world, remittance firms and correspondent banks are faced with a constant threat of having that access withdrawn, typically through being denied a bank account by larger international banks.

The issue continues to draw attention from industry groups, regulators, standards-setters and governments — yet, according to Spindler, remains as prominent as ever.

“I don’t think the de-risking problem is dissipating,” he said. “I don’t think it’s getting any better right now. There's not been a lot of action, and still there’s a tendency just to analyse this without figuring out ways to move forward.”

Spindler is president of the FSVC, a non-profit organisation that aims to strengthen the financial sector in developing countries. It has devoted significant attention to de-risking, and in August last year published a paper penned by Spindler setting out suggestions for a “multi-pronged approach” on tackling de-risking.

He also serves on the board of the Dubai Financial Services Authority and was previously senior vice president at the Federal Reserve Bank of New York.

At the heart of the crisis is a series of competing interests. Independent experts have described de-risking as a “ market failure” as all relevant parties are behaving rationally and in their own interests.

International banks often blame regulators for unclear guidance and heavy-handed enforcement, making the provision of services toc risky to justify the relatively low revenue it generates.

Regulators typically insist on a risk-based approach rather than a blanket denial of services, yet have repeatedly highlighted compliance concerns and weak supervision as reasons for continuing to see the remittance sector as high risk.

But remitters complain that no matter how strong their crime-fighting systems and controls, banks remain unwilling to continue interacting with them. The end result is that, to this day, major financial institutions continue to de-risk by denying such firms access to a bank account.

“In recent months I have listened to the deputy governors of two emerging market central banks give presentations that made clear that the impact of de-risking on their countries is tremendous, and it’s much greater than just loss of correspondent bank accounts,” Spindler said.

“It’s affected the way their whole economies function, it has decreased investor interest in their countries, it’s even affected the way local business communities want to operate. They have become less interested in import and export businesses because they can’t get financing for those activities.”

De-Risking: Assessing The Impact

It is far from straightforward to assess accurately the scale of de-risking, for various reasons.

Spindler said that authorities in some affected regions are often reluctant to go public, not least because they can feel embarrassed by announcing to the global market they have lost their correspondent banking relationships.

Some regions have bucked that trend; officials across the Caribbean, for instance, continue to be relatively vocal on the issue as setbacks continue.

Mark Brantley, finance minister of St Kitts and Nevis, told local radio station WINN FM in December that if correspondent banking relationships are lost completely, the result is businesses and citizens losing the ability to send funds, accept foreign payment cards or pay for imports.

“All of a sudden the country is cut off — what are we going to do? Barter? You give me two fish and I give you two mangoes? That’s what’s going to happen,” said. “These things represent an existential threat to the existence to the people of these halcyon isles.”

There have been attempts to force influential authorities into taking action. The United States' Government Accountability Office published the results of a study into de-risking in March last year, concluding that the Treasury should assess whether a shift in cross-border flows from the formal to the informal sector poses a risk in terms of anti-money laundering.

Despite citing a World Bank estimate that the country is the world’s largest sender of remittances, with outbound flows standing at around $67bn, the report said nine of 12 money transmitters it questioned had resorted to using channels outside the banking system such as ferrying cash.

> “All of a sudden the country is cut off — what are we going to do? Barter? You give me two fish and I give you two mangoes? That’s what’s going to happen,” said Mark Brantley, finance minister of St Kitts and Nevis. “These things represent an existential threat to the existence to the people of these halcyon isles.”

At the same time, almost half of the banks questioned confirmed they had terminated relationships with money transmitters between the start of 2014 and the end of 2016.

But in May, the US Treasury issued a response stating its “existing mechanisms ... allow it to monitor risks and take corrective action”, and officials within its Office of Terrorist Financing and Financial Crimes have ruled out any new legislative action.

Speaking at an industry event in October, policy advisor Jonathan Fishman attempted instead to reassure banks that they would not face huge fines or public censure if they offer services to a fund transfer company that turns out to be handling illicit funds, provided systems and controls are up to scratch.

Some 96 percent of violations result in a no-action letter, he said, arguing that industry perceptions of a zero-tolerance approach are wide of the mark.

Regulators Urged To Step Up

Other authorities have also sought to address the problem, not least the Financial Stability Board (FSB). The FSB presented two reports to the G20 group of world leaders in March last year, one focused on correspondent banking and one on remittances.

Spindler praised those efforts, but said that without wider support from regulatory authorities there is only so much that can be achieved.

“They’re making a genuine effort to bring relevant parties together at the same table to talk about what to do. It’s really valuable to bring these parties together,” he said.

“However, some key regulators are often not in the room, and at the top of the list is the need for US regulators to be there, given the dominant role of the dollar in international payments and trade transactions.”

> “There’s not sufficient coordination across these regulators with regard to these issues,” Spindler said. “The state of New York for example — I haven’t been in a discussion on de-risking myself where they were in the room, and they’re levying significant fines.

Enforcement agencies and regulatory authorities in the United States have been at the forefront of the discussion on de-risking. The Obama-era initiative Operation Choke Point was widely blamed for reducing banks’ risk appetites, and still haunts the industry despite its closure by the Trump administration.

Last year’s Government Accountability Office report found “several banks reported that they had closed the accounts of money transmitters because of the high cost of due diligence actions they considered necessary to minimise the risk of fines under Bank Secrecy Act regulations”.

According to the FSVC chief, the sprawling nature of the United Staes' regulatory regime complicates matters further. Not only are there multiple federal-level authorities that supervise compliance within the banking sector, but powerful state-level bodies such as New York’s Department of Financial Services.

Major enforcement action is often taken jointly by two or more of those bodies, with each issuing its own financial penalties, but when it comes to de-risking that collaborative spirit is too often lacking.

“There’s not sufficient coordination across these regulators with regard to these issues,” Spindler said. “The state of New York for example — I haven’t been in a discussion on de-risking myself where they were in the room, and they’re levying significant fines.

"Regulators have to be much more coordinated in the messages they're delivering to the banking community and the financial sector."

FATF: A Cause for Optimism?

That said, there are signs that the increased attention on de-risking by certain influential groups could be having an impact. Spindler singled out the Financial Action Task Force (FATF), a global standards-setting body, as an example.

One of FATF's main roles is to inspect countries' anti-money laundering and counter-terrorist financing regimes — a process known as mutual evaluation — to check whether regulatory frameworks are up to scratch and that existing rules are being properly enforced.

Historically, the task force has faced stinging criticism from some quarters, accused of lacking the tools to ensure national authorities put its recommendations into practice. But more recently the tide seems to be turning, and countries placed on its high-risk "blacklist" can expect to suffer material consequences.

"The FATF mutual evaluation process really has teeth right now, and I think most emerging market countries are understanding this," Spindler said.

"If they don't do well in a mutual evaluation, and that evaluation is then made public as it always is, they could be virtually cut off from the international financial system.

"On the contrary, if they do perform well in a mutual evaluation, when that is put out in the public domain, that could really improve a country's chances of restoring correspondent relationships."

Spindler said that he attended part of one evaluation and described it as "an intimidating process", comparable to a court proceeding.

"I think word has spread in the emerging market world regarding the power and importance of this process," he said.

> "We may see a new class of banks developing, smaller banks — not large international dollar clearers — that may be able to offer correspondent banking services to these countries, perhaps with a higher fee structure and on a term basis," Spindler said.

If coupled with stronger due diligence and know your customer (KYC) procedures, as well as tighter supervision from national authorities, the result should be greater confidence in dealing with such countries and their financial institutions.

At the market level, even though most international banks still have little risk appetite for servicing correspondent banking and remittances, some institutions could be encouraged to see de-risking as an opportunity to step into the space left by their larger rivals' withdrawal.

"If they simply could be satisfied that they're not going to face humongous fines in supporting these relationships, that might encourage some banks to go back in," Spindler said.

"We may see a new class of banks developing, smaller banks — not large international dollar clearers — that may be able to offer correspondent banking services to these countries, perhaps with a higher fee structure and on a term basis.

"We're hearing that some of these smaller banks are going back to countries that have been de-risked and saying we will provide correspondent banking services for a year. The fees are probably higher than the country was experiencing in the past, but this new class of bank is offering to restore the relationships."

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