



Statement for the Record

Of the

BAFT (Bankers Association for Finance and Trade)

Before the

Committee on Financial Services

Of the

United States House of Representatives

On

September 14, 2022

Chairwoman Waters, Ranking Member McHenry, and Members of the Committee:

BAFT (Bankers Association for Finance and Trade) is grateful for the opportunity to provide a statement for the record for the Committee’s hearing on “When Banks Leave: The Impacts of De-Risking on the Caribbean and Strategies for Ensuring Financial Access.”

BAFT is an international financial services industry association whose membership includes nearly 300 financial institutions and solution providers throughout the global community. Our members are active in correspondent banking, acting as both providers and users of correspondent banking services. Correspondent banking is vital to cross-border economic commerce, and is particularly essential in the Caribbean, where there is a high dependence on foreign goods, services, and connectivity to the U.S. financial system. Banks have adopted a risk-based approach to correspondent banking, consistent with regulatory guidance.

In the context of correspondent banking, de-risking has been used to describe the practice of exiting correspondent banking relationships due to excessive risk associated with the respondent bank. These relationships, however, are often discontinued because of high costs or a strategic change in business or market focus of the correspondent. Putting aside the latter, the most fundamental reason for de-risking is an imbalance in a simple equation: **cost + risk > value of the business**. However well intentioned, any potential solutions to de-risking must address that imbalance.

Contributing costs can include initial customer due diligence (CDD), customer onboarding, annual maintenance, periodic Know Your Customer (KYC) reviews, transaction monitoring (on top of core transaction processing costs), and compliance reporting. Risks can include country-level risk, institutional-level risk, transaction-level risk, and reputational risk if something goes wrong. In

addition, money laundering violations could result in significant fines and penalties valued well in excess of the income related to the business. Increased respondent bank risk can also increase the cost of due diligence, transaction monitoring, and compliance reporting.

Private and public sector stakeholders have undertaken efforts to reduce the costs and risks associated with correspondent banking; however, de-risking is still an issue in some jurisdictions such as the Caribbean. BAFT participated in the April roundtable hosted in Barbados by Chairwoman Waters and Prime Minister Mottley and supports several of the recommendations coming from that meeting, including the harmonization of standards and best practices, the establishment of a certification for examiners, additional training for bankers, and a commitment to ongoing forums to improve outcomes.

We also believe that to make a material difference in the outcomes for de-risked banks, we must consider some material shifts in approach. We encourage the Committee to consider the following.

Establish a Licensing Framework for Respondent Banks

Establishing a framework whereby respondent banks are “licensed” to be eligible for correspondent bank accounts could significantly reduce redundant CDD costs. The “agent” would conduct thorough due diligence and transaction analysis, and if deemed acceptable, the respondent would be issued a license. Correspondent banks could rely on this license, limiting the amount of due diligence they also conduct, and would also be limited from penalties for banking a licensed respondent.

Consider the parallel to the licensing framework for drivers. The government authorizes agencies to conduct background checks, administer assessments to ensure the applicant understands applicable laws and rules, and conduct a field assessment to verify that the applicant can safely perform what’s needed (in practice). After satisfying all the requirements, the applicant receives a license. Rental car companies can rely on this license when renting a vehicle. They may impose insurance and additional conditions (e.g., minimum age, credit card, etc.). However, if a customer happens to use the rental car in the commission of a crime, the rental car company has limitations on its liability provided they rented to a properly licensed driver. If each rental car company were required to conduct its own background checks, driver tests, and were subject to large fines or penalties if one of its customers used the rental vehicle while committing a crime, the entire industry might collapse under its own weight, and car rental companies would significantly restrict to whom they rented cars based on risk profile. Applying a similar licensing framework to correspondent banking could lower both the cost and risk to correspondent banks.

Designate a Correspondent Bank for Qualified Institutions

Like development banks, an institution could be established or designated for the purpose of serving as a correspondent bank for qualified institutions that cannot obtain a correspondent relationship elsewhere. This potentially solves for institutions whose business is too small, but not too risky. The respondents would still be subjected to due diligence to ensure they meet minimum compliance standards and are not a magnet for illicit funds flow. From a regulatory perspective, the designated correspondent would be supervised with the explicit understanding that they are supporting de-risked institutions. It may be necessary to subsidize the operations

of this entity but could potentially be packaged as part of foreign aid in collaboration with the governments of the respondent.

Clarify Hub Banking Protocol

Like the correspondent scenario discussed above, some medium sized banks with strong knowledge of the market and lower operating costs may choose to provide downstream correspondent services to small banks. Many of these institutions are respondent banks, and these arrangements are often referred to as “nesting.” Regulators have sent mixed signals as to the acceptability of these arrangements, causing many upstream correspondent banks to re-evaluate their relationships with hub banks providing downstream services. This can be a disincentive to banks to act as hub banks, for fear of losing their own correspondent relationships. Providing clarity and guidelines for these arrangements might incentivize banks in the Caribbean (and other regions) to aggregate business for smaller institutions, thereby increasing the value of the business for an upstream correspondent.

Each of the above recommendations requires full vetting and must be done in a way that does not jeopardize the integrity and resilience of the financial system. However, each addresses the imbalance in the core equation that usually triggers de-risking. We would be happy to lend support to develop these ideas further.

Thank you again for the privilege of providing the Committee with our views.