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De-risking
Effects, Drivers and Mitigation

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Acronyms and Abbreviations

AML	anti-money laundering
CBR	correspondent banking relationships
CDB	Caribbean Development Bank
CFT	combatting the financing of terrorism
FATF	Financial Action Task Force
FDI	foreign direct investment
fintech	financial technology
IFIs	international financial institutions
IMF	International Monetary Fund
KYC	know your customer
KYCC	know your customer's customer
MTOs	money transfer organizations
SARs	suspicious activities reports

Executive Summary

Banks and other financial services providers in a number of small countries around the globe are faced with the loss of their correspondent banking relationships (CBRs) as large international banks that provide access to the global payments and settlement system close accounts or restrict the range of services they provide. This "de-risking" is driven by a number of factors, including the increasing cost of complying with regulations for anti-money laundering (AML) and combatting the financing of terrorism (CFT). In particular, the incidence of very large fines and penalties and the difficulty of assessing the threat of non-compliance has greatly increased operational risks faced by banks and other financial institutions. In the post-financial crisis environment of higher capital and liquidity requirements, banks and other financial institutions may terminate CBRs and other business lines in smaller countries. These jurisdictions have smaller markets, making it difficult for banks providing CBRs to spread the costs of assessing the adequacy of AML and CFT regimes over a larger volume of transactions. Because de-risking represents a threat to the countries directly affected as well as to international development objectives, and may entail unintended consequences with respect to the goals of AML/CFT that undermine efforts to safeguard the integrity of the global payments system, it is a problem shared by the international community. Mitigating its effects will require a shared response.

Introduction

A new economic threat hangs over many small developing countries on the periphery of the global economy. There are growing concerns that many of these countries could lose access to the global financial system — an outcome that would not only threaten the growth and prosperity of the affected countries as they lose access to the international trade and payments system, but could also undermine broad international objectives, including the progress made toward poverty alleviation and international development. And for large advanced countries at the core of the global economy, there are potential consequences for ongoing efforts to protect the integrity of the global payments system. Such effects may impair the fight against criminal networks and efforts to counter the financing of terrorism.

This paper examines the phenomenon of de-risking, or the loss of financial services as large international banks close or curtail CBRs with banks in smaller jurisdictions. It outlines the effects of de-risking and identifies a range of possible measures to mitigate them. While affected jurisdictions bear the financial costs, de-risking is a shared problem, requiring a shared response. This response includes efforts by affected countries to comply with international AML and CFT standards. As the country with the largest financial system and the leader among AML/CFT standard setters, the United States has a key role to play; however, it is not the only country with an interest in maintaining the integrity of the global financial system. Today, global banks operate across a range of jurisdictions, regardless of the country in which they are licensed; therefore, an effective strategy for addressing the challenge of de-risking requires international cooperation. In this regard, the shared goal should be to achieve key objectives that all members of the international community seek — mitigating the effects of de-risking while protecting the integrity of the global payments system and guarding against criminal and terrorist threats.

Effects of De-risking

While de-risking is a problem for the global community, in the first instance, smaller jurisdictions are most at risk. These countries face three types of de-risking (see Appendix). The first is the closure of (or refusal to open) bank accounts for certain individuals and firms, and other restrictions on access to financial services. The costs of this form of de-risking — or "de-banking" — are largely borne by individuals. And to the extent domestic banks are capable of providing services for non-cross-border transactions, the costs are largely in terms of limiting financial integration. This form of de-risking does not pose a significant systemic threat to the affected jurisdiction or entail large unintended consequences.

A far more serious problem confronting many smaller countries comes from the loss of CBRs. Banking systems in these jurisdictions are connected to the global payments system through accounts held by domestic banks in large international banks. In a growing number of cases, however, these accounts have been closed as large international banks shed business lines in affected jurisdictions. If replacement accounts are not found, or some alternative arrangements made, an affected institution could find itself unable to process payments or provide a range of financial services to their business and retail clients. This could have serious adverse economic effects for these countries.

These effects operate through four channels: trade, banking, investment and competition. For countries reliant on trade, the loss of CBRs could have significant adverse effects, including lower exports and imports as bank customers are unable to send or receive foreign payments and maintain business relationships with foreign customers and suppliers. Such direct effects have indirect costs, as domestic businesses lose revenues and experience difficulties servicing bank loans. Weakened banks are less able to provide loans and other financial services, with a negative impact on growth. Moreover, a domestic banking system that is less effective in servicing clients could represent a significant deterrent to foreign direct investment (FDI). The loss of FDI can seriously impair growth prospects in these countries, both through the direct loss of investment expenditures and a longer-term, dynamic effect. FDI embodies new technology and managerial expertise that raises total factor productivity that once introduced spillovers to other sectors of the economy. In addition, for small jurisdictions facing the greatest threat of de-risking, increased financial and trade autarky could impose a dynamic cost through reduced competition and increased rent-seeking behaviours. For these countries, the competition provided by potential imports may serve as a useful check on monopoly pricing and a source of growth.

The third type of de-risking is the withdrawal or restriction of services to money transfer organizations (MTOs). This can have a particularly pernicious effect on the poor in countries dependent on remittances from abroad. While all regions have been affected to a greater or lesser degree, Latin American and Caribbean countries are particularly vulnerable (see Table 1). The loss of such income could threaten progress made toward global goals for reducing poverty. In this respect, the effects of remittances depend on the

Table 1: Latin America and Caribbean Region 2015 Remittance Receipts

(US$ billions)		(% GDP)	
Mexico	$25.7	Haiti	22.7
Guatemala	$6.4	Honduras	17.4
Dominican Republic	$5.0	El Salvador	16.8
Columbia	$4.5	Jamaica	16.3
El Salvador	$4.4	Guyana	10.6
Honduras	$3.8	Guatemala	9.9
Brazil	$2.8	Nicaragua	9.7
Peru	$2.7	Dominican Republic	7.5
Ecuador	$2.4	Belize	4.7
Jamaica	$2.3	Dominica	4.5

Source: World Bank Group (2016).

use to which inflows are directed. Remittances increase consumption by relaxing budget constraints. For some countries in the region, this effect is significant; for many individuals in the poorest countries, remittances are a critical source of income. Higher costs for transferring money have a direct impact on these households. Inflows that account for a sizeable share of GDP are likely to lead to an appreciation of the real exchange rate; however, if this effect is sufficiently large, export earnings may fall, with a negative impact on GDP. These effects would be reduced if remittances finance investment, including in human capital, which raises productive capacity.

These effects would be expected to depend on the level of financial sector development and policy frameworks. Pablo Fajnzylber and J. Humberto López (2008) provide evidence that suggests remittances are more effective in both raising investment and enhancing growth in countries with higher levels of human capital, strong institutions and sound policy environments.[1] Paradoxically, they also find that increases in remittances have more of an investment and growth impact in countries with less-developed financial sectors. One possible reason for this result is that remittances can be seen as relaxing liquidity constraints faced by the poor; such constraints would be more relevant in countries with less developed financial sectors.

At the same time, the loss of services to MTOs has potential unintended effects on AML and CFT efforts. By facilitating the efficient transfer of remittances, MTOs provide vital services to millions around the globe. The need for these services remains even after CBRs are de-risked and some means will be devised to complete the transfer of funds. The danger is that such workarounds open pathways for the financing of illicit activities as legitimate transactions are driven into the shadows. The larger the informal sector, the easier it may become to conceal the origin and nature of suspicious transactions. The goals of AML/CFT may become more elusive.

1 Craig Burnside and David Dollar (2004) argue that the impact of aid flows on the growth rate of recipient economies depends on whether the policy environment is favourable to private investment. Sound policy environments increase the return on investment (or reduce the risk associated with a given return), and raise the opportunity cost of consumption.

Drivers of De-risking

The de-risking phenomenon reflects the interplay of a number of factors. Three stand out:

- **AML/CFT reporting requirements:** Reporting requirements on banks and other financial institutions have increased significantly over the past four decades. Originally targeted at money laundering activities of organized crime, US AML regulations have expanded over the years and have been supplemented by CFT measures under the Patriot Act of 2001, as well as tax transparency requirements. Other countries have followed and such measures are coordinated at the international level.
- **Large fines and penalties:** The second factor contributing to de-risking is large fines and penalties that have been imposed in recent cases of non-compliance. In some successful prosecutions, the amounts assessed have been truly enormous.
- **Increased capital requirement:** The third factor responsible for the increased threat of de-risking is higher capital requirements and liquidity requirements on regulated financial institutions introduced following the global financial crisis. These more stringent requirements reflect the wholly understandable objective of preventing another financial crisis similar to 2007-2008.

These three factors come together in subtle ways to significantly increase the challenges of providing a full range of banking services. The increasing range and complexity of AML/CFT regulations, for example, may introduce an element of uncertainty in terms of regulatory expectations — in particular, the degree of due diligence required to comply with requirements. This has led to increased compliance costs, as banks seek to remain "on side" with law enforcement and national security authorities. These higher costs may have larger effects on jurisdictions, with smaller banking markets processing fewer transactions. This effect could reflect AML/CFT compliance costs that include a fixed-cost component, since smaller jurisdictions would be less able to spread costs over a larger number of transactions resulting in higher average fixed costs.

The effects of an increased level of uncertainty are magnified, meanwhile, by the large fines and penalties levied in a few highly publicized cases. With greater uncertainty regarding the possibility of prosecution for non-compliance, and multi-billion dollar fines, the expected value of the potential direct costs (not counting costs to reputation and loss of franchise value) increases. Needless to say, from the perspective of banks confronting these costs, this is worrying enough. But the challenge is magnified in an environment of enhanced capital and liquidity requirements.

Banks' risk management exercises typically involve the notional allocation of capital to cover three distinct risks — credit, market and operational risks. Credit risk is the potential loss the bank incurs from borrowers failing to repay their loan commitments on time and in full. Market risk arises when asset prices, interest rates and exchange rates move in a manner that adversely affects the bank's balance sheet. Operational risk, meanwhile, reflects potential losses from a myriad of causes; these can include information and technology problems (i.e., hacking), reputational loss or litigation costs. The potential costs of non-compliance with AML/CFT regulations fall in the third basket. Given post-crisis financial regulatory requirements that increase required capital holdings against credit and market risks, banks have sought to reduce the amount of capital allocated to operational risk.

Taken together, these factors suggest that de-risking has emerged as a serious problem for a number of countries because increased uncertainty, coupled with high fines and penalties, and a regulatory environment that has placed pressure on capital ratios, have led banks to scrutinize their business lines more carefully. This assessment supports the view that banks have adopted a strategy of withdrawing from activities that they do not consider part of their core business.

To see this result, consider the problem facing a bank with correspondent relationships with other banks in other jurisdictions. The bank seeks to maximize profits subject to the probability, p, of incurring a fine for violating AML/CFT regulations. If the fine is a fixed amount, F, and the probability of a fine is likewise fixed, the bank compares the expected value of providing correspondent banking services (and possibility incurring a fine) against the profits from de-risking, which eliminates the threat of a fine — in effect, drives p equal to zero. While total revenues under de-risking may be strictly less than revenues before de-risking, so too are expected costs. In this respect, the bank will de-risk unless the profits from providing CBRs are large enough to compensate for the expected value of the fine, $p \bullet F$.

For jurisdictions adversely affected by de-risking, this condition is unlikely to hold. This assessment reflects recent fines and penalties levied against banks found to be non-compliant with US AML/CFT provisions. The largest fine and penalties imposed to date, approximately US$9 billion,[2] may make it unprofitable to provide CBRs unless the probability of prosecution is vanishingly small: consider, for example, that a 10 percent probability of being prosecuted would equate to an expected value of US$900 million. The potential profits of an individual bank in small jurisdictions would not justify the risk of being fined.

The expected value calculation above assumes that banks can affix a value to the probability of prosecution. This might be possible if there is a significant prior history of cases from which the bank could infer a frequency distribution, conditional on a range of factors — the nature of the transaction, jurisdiction, and client type and so on. But this is unlikely to be the case. There have been too few observations for banks to accurately assess the probability they face with any degree of confidence. Large international banks therefore confront "Knightian uncertainty" — the inability to assess the expected value of prosecution. Given the limited number of observations and the wide range of the fines, the prudent course of action, from the bank's perspective, may be to avoid the risk entirely by de-risking.

This effect is illustrated in Table 2, which provides the expected value of hypothetical fines over a range of possible fines and probabilities. The spread between possible outcomes is enormous: the expected value of the highest fine is a staggering 500,000 times the size of the lowest. While these amounts are illustrative, they demonstrate the enormous uncertainty that banks may face when deciding whether to maintain CBRs.[3]

2 See US Department of Justice (2015).

3 Knightian uncertainty may also block efforts to provide an indemnity or insurance against potential fines and civil penalties. The premium for such protection must reflect the intrinsic uncertainty associated with the expected value of possible fines; these could be sufficiently high as to make insurance unprofitable. Similarly, absent some external support, smaller jurisdictions most threatened by de-risking would lack the financial resources required to make a credible commitment to indemnify a bank successfully prosecuted for AML/CFT non-compliance. At the same time, a moral hazard problem exists: banks with insurance or an indemnity would have reduced incentives to exercise oversight of transactions, increasing the expected costs to the insurer or jurisdiction providing the indemnity. Notwithstanding these challenges, however, with support from the international community, it may be possible to structure an intervention that provides an indemnity with strict oversight of AML/CFT and other policy actions to address weaknesses in regulatory frameworks and other areas.

Table 2: Expected Value of Possible Fine ($ millions)

Fine	Probability of Penalty					
	$p = 0.001$	$p = 0.01$	$p = 0.05$	$p = 0.10$	$p = 0.20$	$p = 0.50$
$0.5 billion	0.05	0.5	2.5	5	10	250
$1 billion	0.1	1	5	10	100	500
$5 billion	5	50	250	500	1,000	2,500
$10 billion	10	100	500	1,000	2,000	5,000

Possible measures to reduce Knightian uncertainty include the provision of a "safe harbour" for banks seeking greater clarity with respect to the conditions under which a bank could face prosecution for AML/CFT non-compliance. In a sense, the hypothetical effect of the safe harbour in reducing intrinsic uncertainty could, for example, be analogous to truncating the range of probabilities in Table 2 by eliminating the columns to the right of $p = 0.05$. This reduces the standard deviation of expected value of fines from $1,122 million to $145 million. But, while this greatly reduces the range of possible outcomes, the gap between the highest and lowest possible fines remains huge. For banks providing CBRs that face competitive market conditions, the risks of operating in small jurisdictions that may entail a higher probability of prosecution may simply be too great. Rather than take the risk associated with maintaining a CBR, it may be preferable, from a business perspective, to exit the market.

This result can be explained using the fact that the bank maximizes profits by determining the number of transactions or business lines, n, to complete. For the moment, it is helpful to consider the bank's operations in a particular jurisdiction. The bank chooses n to maximize the expected value of profits, where revenues and costs are a function of the number of transactions or business lines maintained. These revenue and cost functions vary across jurisdictions; it is not unreasonable to assume, however, that revenues per transaction are higher and cost per transaction lower in larger jurisdictions owing to economies of scale and scope. In any event, the condition for the optimal choice of n is the familiar result that marginal revenue equals marginal cost: adding one more transaction (business line) means that the increase in revenue does not compensate for the increase in costs; one fewer transaction would imply foregoing potential revenue that exceeds the incremental increase in cost.

While this condition determines the number of transactions to undertake, it does not necessarily imply that the bank would maintain CBRs. For it to do so, profits would have to be positive. In other words, in addition to the first-order condition, a non-zero profit condition must be satisfied.

Adding a fixed penalty, F, to the bank's problem is equivalent to shifting the cost curve up by the amount of the fine times the probability of prosecution. Several scenarios are possible. For example, at a given probability of prosecution, the expected value of the fine may be such that the bank makes zero expected profits (which would be the expected outcome under competition and free entry into banking). For any probability greater than that level, the bank would earn negative profits, leading to a decision to de-risk.

To see how the characteristics of different banking markets affect de-risking decisions, consider the case of a large international bank offering CBRs in two separate jurisdictions — one small, one large. For simplicity, assume that the two banking markets share a common cost function but that the revenue function in the larger jurisdiction lies everywhere above that of the smaller jurisdiction.[4] In the absence of potential penalties for AML/CFT, the bank would operate in both banking markets, albeit processing fewer transactions in the small jurisdiction. Once the expected value of potential fines is added, however, it may no longer be profitable to operate in the smaller jurisdiction. This is because the cost function augmented to include the expected value of fines and penalties could

4 In practice, smaller jurisdictions likely also face higher cost functions for a variety of reasons. This effect would reflect, for example, certain fixed costs, which much be incurred on entry to a particular banking market. Such costs might include the establishment of AML/CFT compliance programs, which in larger jurisdictions can be spread over a much larger number of transactions. At the same time, compliance costs may be lower in larger jurisdictions because investments in information technology are warranted by a larger market and/or access to publicly funded databases that facilitate the determination of beneficial ownership.

lie above the total revenue function of the smaller jurisdiction. This would imply negative profits in the smaller jurisdiction. In such circumstances, the bank would opt to de-risk by exiting the market.

This result helps explain the combination of factors that contribute to the phenomenon of de-risking. Smaller jurisdictions that offer lower revenues per transaction face an intrinsic disadvantage.[5] Actions that expand the size of the banking market and allow for greater economies of scope to raise the revenue function, on the one hand, and economies of scale that lower the cost function, on the other hand, would help. So, too, would continued efforts to provide greater clarity on the probability of legal action and the potential fines associated with prosecution. At the same time, Knightian uncertainty, which increases the uncertainty associated with the expected value of possible prosecution, leads to de-risking; with higher probabilities, fewer jurisdictions would be served, leaving only the most profitable banking markets benefiting from continued access to CBRs. Finally, efforts to reduce the costs of AML/CFT compliance, either through the adoption of technologies that facilitate information sharing, or legislative reform, would drive down costs, increasing the likelihood that a given jurisdiction is able to retain CBRs.[6]

Mitigation Efforts

Efforts to reduce the effects of de-risking must address one or more of the key drivers of the phenomenon. To begin, it is unrealistic to assume that reporting requirements under AML/CFT regulations or higher post-crisis capital and liquidity buffers will be significantly relaxed. Nor would that be desirable, given the fundamental objectives these measures promote. That being said, efforts to clarify regulatory expectations with respect to AML/CFT provisions could reduce the Knightian uncertainty associated with the existing regime.

US regulatory authorities have already made important progress toward this objective. Joint statements in 2016 sought to clarify the extent of due diligence and make clear that cases of successful prosecution leading to large fines and penalties involved persistent, willful and flagrant violation of regulations. The guidance provided by US regulators stressed that an overwhelming majority (about 95 percent) of compliance deficiencies are corrected without enforcement action or penalty.[7] The very large penalties assessed in some cases were based on a large number of transactions by institutions involved in repeated violations, not from isolated, inadvertent instances of non-compliance. Similar clarifications have been issued by international bodies (Financial Action Task Force [FATF] 2016).

Of course, the onus is clearly on the affected jurisdictions to achieve and maintain international best practice with respect to AML/CFT standards. In addition, banks and MTOs in these jurisdictions should be encouraged to employ state of the art data utilities for determining beneficial ownership and information-sharing practices. Unfortunately, the small size and fragmented nature of these banking markets may pose a barrier to the investments in information-processing technology that are needed, for the reason cited above, while a profusion of different national regulations increase the costs of compliance. Consideration could, therefore, be given to possible initiatives to expand regional banking markets, including complementary efforts to promote greater trade and monetary cooperation.

At the same time, efforts to reduce the costs of compliance may also be helpful in mitigating the effects of de-risking. Table 3 summarizes a range of measures to reduce the compliance costs

5 Some readers might find this assumption unrealistic. Regardless, the same result could be obtained from assuming the same revenue function between large and small jurisdictions but with different cost functions. The key point is that there is an important cost component to the de-risking problem that cannot be ignored.

6 It is also possible to consider (but difficult to illustrate) the case in which the probability of being prosecuted for non-compliance is a function of the number of transactions undertaken. This might reflect a situation in which the greater the number of transactions, the greater the likelihood AML/CFT regulations are unwittingly and unintentionally violated.

7 See US Department of the Treasury and Federal Banking Agencies (2016) and Office of the Comptroller of the Currency (2016), which establishes the expectation that decisions to close CBRs on the basis of risk evaluations, are based on "analysis of the risks presented by individual foreign financial institutions and the bank's ability to manage those risks." Concerns have been raised, however, that such requirements increase compliance costs (The Clearing House 2017). A more cost-effective safe harbour, it is argued, would entail enhanced legal certainty regarding the use and disclosure of suspicious activities reports (SARs), clearer standards of what constitutes a reasonable AML/CFT program and detailed guidance on due diligence on customers of customers, or the standard of "know your customer's customer" (KYCC), when an institution can reasonably rely on another institution or by a utility.

Table 3: Possible Measures to Reduce US AML/CFT Compliance Costs

Challenge/Problem	Measure	Status
Absence of prioritization and clarification of regulatory expectations	Address disconnects between information collected on the basis of SARs requirements and actionable prosecutions.	Unclear.
	Clarification of due diligence with respect to KYCC.	Some progress.
Barriers to information sharing	Provide safe harbour for the sharing of information by changing Section 314(b) of the US Patriot Act to allow financial institutions to fill in missing "gaps" on AML/CFT risk profiles.	Draft legislation (H.R. 5606) introduced in 114th Congress; expected to be reintroduced.
	Allow US depository institutions to share SARs with foreign branches or affiliates in FATF member countries.	See above.
	Promote the use of KYC utilities by respondent and correspondent banks, with standardized minimum set of information and data.	Unclear.
More efficient information gathering and monitoring	Information on beneficial ownership recorded at time of incorporation and whenever such information changes. Protocols for sharing information with financial institutions.	Draft legislation (H.R. 4450) introduced in 114th Congress; expected to be reintroduced.
	Adopt Legal Entity Identifier in correspondent banking.	Unclear.
Centralization of data evaluation	Utility that allows banks to share bulk data (with privacy safeguards) for analysis.	Evolution of technology allows for the evaluation of big data by central agency.

Source: Based on The Clearing House (2017); Committee on Payments and Market Infrastructures (2016); and Lowery and Ramachandran (2015).

associated with US AML/CFT regulations that have been proposed by a range of different groups.

Key measures proposed include:

- more specific guidance on suspect transactions that are likely to lead prosecutions to better focus banks' SAR as well as further clarification of requirements on due diligence vetting of customers' customers;
- reducing the barriers to the sharing of information between financial institutions and promoting use of know your customers (KYC) utilities;
- more efficient information gathering and monitoring by identifying beneficial ownership and the use of legal entity identifier; and
- development of a utility that allows for the sharing and analysis of bulk data (with privacy safeguards).

It might also be possible to reduce AML/CFT compliance costs through a comprehensive review of the existing regulatory framework. The intention would be to achieve the critical objectives of the regulations at lower cost to domestic banks and with less economic damage to affected jurisdictions. The potential for unintended consequences, by which de-risking may facilitate illicit transfers by driving legitimate transactions into the "shadows" of informal channels, is a compelling justification. This would likely be a daunting challenge, yet one that could yield great benefits.

Stakeholders in Mitigation

The discussion above suggests that there is a broad coalition of stakeholders whose interests are at play in the de-risking issue. These players include regulators in the home jurisdictions of large correspondent banks, as well as the banks themselves and, similarly, the respondent banks and regulatory authorities of affected countries. Moreover, given the essential public good nature of a well-functioning global payments system, international financial institutions (IFIs) are also implicated.[8]

The institutions have responded. The International Monetary Fund (IMF) has identified de-risking as a key priority, consistent with its mandate to safeguard international financial stability and facilitate orderly international trade and payments. Fund staff have provided key analytical support to members affected by de-risking, while Fund management has used its convening power to bring interested stakeholders together.[9] The World Bank has conducted surveys of the problem and is collaborating with other institutions and with the Group of Twenty on the issue. Meanwhile, the Caribbean Development Bank approved a pilot program to strengthen implementation of and compliance with international standards and to increase the technical capacity of banks and credit unions to conduct customer due diligence.[10]

Other international bodies are also working on efforts to mitigate the effects of de-risking. The Financial Stability Board is following a four-point action plan to assess and address the problem of de-risking and has created a Correspondent Banking Coordination Group to coordinate and sustain efforts on the action plan.[11] And as noted above, FATF has clarified expectations with respect to due diligence and ancillary information needed to implement a risk-based approach.[12] Similarly, the Basel Committee on Banking Supervision/Bank for International Settlements has provided greater clarity with respect to due diligence and transparency regarding cover payment messages related to cross-border wire transfers.

These are important steps. But given the public good nature of the twin goals of safeguarding the integrity of the global payments system while preserving access to CBRs, more needs to be done. Three areas stand out. First, many smaller jurisdictions must build the technical capacity to effectively monitor and enforce AML/CFT standards. This implies a multi-year program of technical assistance and capacity building. The international community can facilitate this knowledge transfer; the IFIs clearly have a role through regional technical assistance programs, but so too do the larger members of the international community that drive international standards. Second, consideration should be given to a multilateral response to the challenges of facilitating the sharing and analysis of information through new utilities. The World Bank and regional development banks, as well as national governments and central banks, all have a role to play. Third, to the extent that the application of innovative financial technology (fintech) could be mobilized to support financial inclusion, there is a policy imperative for governments to work closely to establish a sound regulatory framework for new financial-based applications that balances stability and innovation. The need to cooperate on a regulatory framework for fintech is especially relevant in the context of the potential unintended consequence of driving licit transactions into the shadows.

8 The World Bank has published two surveys (2015a and 2015b), both in November 2015. The IMF (2016) published a staff discussion note in June 2016. Meanwhile, the Caribbean Development Bank (CDB) has focused on the effects of de-risking on Caribbean countries (see Boyce and Kendall [2016]).

9 Christine Lagarde (2016), managing director of the IMF, has noted: "Correspondent banking is like the blood that delivers nutrients to different parts of the body. It is core to the business of 3,700 banking groups in 200 countries."

10 The CDB will partner with the Multilateral Investment Fund of the Inter-American Development Bank and the Office of the Secretary of the Association of Supervisors of Banks of the Americas.

11 The action plan includes: examination of implications, including collection of data on scale of withdrawal, its causes and effects; clarification of regulatory expectations, including through guidance by the FATF; expansion of domestic capacity building in affected jurisdictions; and strengthening tools for customer due diligence by correspondent banks.

12 Such information requirements include knowledge of the respondent bank's business model, reputation and quality of its supervision, in particular whether it is subject to a money laundering or terrorist financing investigation or regulatory action, and an assessment of its AML/CFT controls.

Conclusion

A number of small countries on the periphery of the global economy are threatened by the loss of access to the international payments system. Many of these countries have laboured to reduce high debt burdens and put their economies on a path of sustainable long-term growth and development. These efforts could be undermined by de-risking. While this outcome would clearly be detrimental to the countries affected, it might also have costs to the international community more broadly as shared development goals are set back. At the same time, there is a possible unintended consequence of driving licit transactions into the shadows, making it more difficult to achieve AML and CFT goals. This effect reflects the fact that informal mechanisms for facilitating financial transactions make it easier to hide criminal or terrorist activities in the shadows. These are shared problems, calling for a shared response by the international community.

Author's Note

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Annex: De-risking Taxonomy

Source	Channels/Effects	Systemic Risk or Unintended Consequence
De-banking	Closure or refusal to open bank accounts to particular individuals. Borne by individuals.	Low risk of systemic effects. Potential impact on AML/CFT goals.
Loss of CBRs	Severing of CBRs with several effects: → trade — reduced trade flows or increased costs of trade; → banking — weakened banking systems less capable of financing investment and more vulnerable to shocks; → investment — possible loss of FDI with direct and dynamic effects on growth; and → competition — adverse growth and welfare effects from loss of competition.	High potential risk of systemic effects for jurisdictions losing access to the international payments clearing system. Possible risk to AML/CFT goals as economic dislocation weakens public finances in affected jurisdictions.
De-risking MTOs	Withdrawal or restriction of banking services from MTOs and other remittances facilities resulting in: → loss of income with direct negative effects on poverty alleviation; and → lower investment with long-term effects on growth and development.	Serious risk to AML/CFT goals as remittance flows are routed through informal channels.

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