

# Is There a ‘New Normal’ for De-risking in the Caribbean?

Scott B. MacDonald<sup>1</sup>

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In early August 2019, it was revealed that large amounts of currency, upwards of \$50 million monthly, are being shipped out of Jamaica. Peter Higgins, who is part of the Bank of Jamaica’s Foreign Exchange Code Working Group, noted that “too much cash is being shipped from Jamaica and to a great extent it cannot be explained.”<sup>2</sup> Though the cash is likely worked through the island’s *cambios* (foreign exchange houses) and not the banks, this movement of cash has heightened the concern of international correspondent banks regarding cash outflows from questionable sources. It also brings back questions concerning the “de-risking” or “de-banking” of global banks from the Caribbean, a development that has caused economic and reputational damage throughout much of the region, as well as being a point of friction between regional governments and the advanced economies in North America and Europe. According to Toussant Boyce, head of the Office of Integrity, Compliance and Accountability at the Caribbean Development Bank, there is a “new normal” in terms of Caribbean finance. But it is questionable whether the new normal is sustainable; if not, it could represent further economic challenges in the region, especially when it comes to access to international finance.<sup>3</sup>

## *What is De-risking?*

Although some have pointed to the financial crisis of 2008-2009 as the beginning of de-risking on the part of major global banks, economies throughout the Caribbean—as well as in parts of Africa, Eastern

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1. Special thanks for the editorial comments from Bruce Zagaris, partner at Berliner Corcoran & Rowe LLP, Venkat Rao, chief compliance officer and financial and operations principal at the Kimberlite Holdings, Inc., and Tony Bryan, president at Anthony Bryan and Associates.

2. Durrant Pate, “Concern over High Amounts of US\$ Shipped Monthly from Jamaica,” *Jamaica Observer*, August 7, 2019, [http://www.jamaicaobserver.com/business-observer/concern-over-high-amounts-of-us-us-222-million-cash-purchased-in-the-first-six-months-of-2019\\_171747?profile=1606](http://www.jamaicaobserver.com/business-observer/concern-over-high-amounts-of-us-us-222-million-cash-purchased-in-the-first-six-months-of-2019_171747?profile=1606); also see: Durrant Pate, “Too Much US\$ Cash,” *Jamaica Observer*, September 4, 2019, [http://www.jamaicaobserver.com/business-observer/jamaica-s-correspondent-banking-issues-far-from-over\\_173954?profile=&template=Printer-Version](http://www.jamaicaobserver.com/business-observer/jamaica-s-correspondent-banking-issues-far-from-over_173954?profile=&template=Printer-Version).

3. Points made by Toussant Boyce at the Caribbean Development Bank during an interview on July 26, 2019.

Europe, the Middle East, and the South Pacific—were the hardest hit by the loss of correspondent bank relationships (CBRs) in the 2015-2018 period. Broadly defined, de-risking refers to the restriction of correspondent banking relationships or business services from major global banks to certain jurisdictions due to concerns over money laundering or potential involvement in the financing of terrorist activities. The guidelines for de-risking (risk management) are found in the anti-money laundering (AML) and Combating the Financing of Terrorism (CFT) regimes that banks are obliged to follow.

According to the World Bank, the products and services identified as being most affected by the withdrawal of CBRs are:

- Check clearing and settlement;
- Cash-management services; and
- International wire transfers.

De-risking has also had a major impact on money transfer organizations (MTOs), which are financial companies engaged in the cross-border transfer of funds, using either their local banking system or having access to another cross-border banking system. The largest of these companies include Western Union, UAE Exchange, MoneyGram, and PayPal. MTOs play an important role in countries with large flows of remittances, such as India, China, and much of the Caribbean.

### *Different Perceptions, Different Realities*

From the perspective of international banks, mainly from Canada, the United States, and Europe, as well as their governmental regulatory agencies, the Caribbean is high risk due to weaker compliance and AML regimes—or at least it has been treated this way. To avoid the pain of being stung by financial fraud, paying large fines, and suffering from reputational risk, many banks opted to radically reduce their exposure to the region.

Since 2008, global banks have been under ongoing pressure to cut costs, while a number of institutions have been tagged by large fines. There is also the issue of higher compliance costs. According to a 2018 World Bank report:

*“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 sanction regimes make 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 transaction volumes and fees to remain a viable activity.”<sup>4</sup>*

Banks pulling out of the region include the Bank of America, Scotiabank, Royal Bank of Canada, and CIBC. Banks from the Netherlands, Germany, and the United Kingdom also restricted their CBR business with Caribbean jurisdictions.

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4. A 2018 World Bank report on the impact of de-risking on a number of developing economies, noted: “In small states, the impact of the decline in CBRs has been acute.” See: World Bank, *The Decline in Access to Correspondent Banking Services in Emerging Markets: Trends, Impacts, and Solutions* (Washington, D.C.: 2018), <http://pubdocs.worldbank.org/en/786671524166274491/TheDeclineReport-low.pdf>.

For Caribbean countries, de-risking has been a major economic problem. A survey in 2017 by the Caribbean Association of Banks found that 21 of the 23 banks in 12 Caribbean countries had lost at least one correspondent banking relationship. The impact was particularly hard on countries in the Eastern Caribbean (in particular Antigua and Barbuda and St. Kitts-Nevis), Suriname, and Belize.<sup>5</sup>

The gravity of the problem was caught by a 2016 discussion paper from the Caribbean Development Bank, which stated:

*“Regionally, there is a looming risk of systemic economic and financial impacts if this issue is not addressed. The Financial Stability Board (FSB) in its recent report to the G20 on efforts to assess and address the decline of correspondent banking . . . noted that the decline of CBRs in the Caribbean could become a systemic issue for the Region. It warned that by driving payment flows underground into the shadow banking sector, the decline in CBRs could exacerbate the region’s challenges with being classified as ‘high risk’ for financial crimes, particularly money laundering and terrorist financing.”<sup>6</sup>*

Most Caribbean economies are dependent on tourism and are open in terms of trade. Bearing this in mind, access to international payment services such as wire transfers, credit card settlements, and hard foreign currency are critical for everything from a tourist being able to pay at a hotel to a local retailer importing food to be used in major resorts, as well as feeding the local population. It is also important for such things as families making payments for their children to attend university in Canada, the United States, and the United Kingdom.

Another part of the problem is that the lack of CBRs complicates the flow of remittances back to the region. In the Dominican Republic, for example, remittances in 2017 were estimated by the central bank to be \$5.7 billion.<sup>7</sup> Indeed, a number of countries are dependent on remittances to help economic growth, as well as for families to meet day-to-day expenses (see table below). Much of the movement of remittances have been done through MTOs, most of which have been left scrambling in the aftermath of de-risking.

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5. See Sheldon McLean et al., *Economic Impact of De-Risking on the Caribbean: Case Studies of Antigua and Barbuda, Belize and Saint Kitts and Nevis* (Santiago, Chile: ECLAC Subregional Headquarters for the Caribbean, 2018), <https://www.cepal.org/en/publications/43310-economic-impact-risking-caribbean-case-studies-antigua-and-barbuda-belize-and>.

6. Toussant Boyce, “Discussion Paper: Strategic Solutions to ‘De-risking’ and the Decline of Correspondent Banking Relationships in the Caribbean,” Caribbean Development Bank, 2016, p. 5, [https://issuu.com/caribank/docs/discussionpaper\\_solutions\\_de-riskin](https://issuu.com/caribank/docs/discussionpaper_solutions_de-riskin).

7. “Remittances to Dominican Rep. to Exceed US\$5.8B in 2017,” *Dominican Today*, <https://dominantoday.com/dt/economy/2018/01/15/remittances-t-dominican-rep-to-exceed-us5-8b-in-2017/>.

Figure 1: Remittance Inflows to GDP for Selected Caribbean Countries (%)

	2014	2015	2016	2017
<b>Barbados</b>	2.4	2.4	2.4	2.3
<b>Dominica</b>	9.6	10.4	9.8	10.4
<b>Dominican Rep.</b>	7.3	7.6	7.6	8.1
<b>Guyana</b>	10.7	9.6	7.7	7.5
<b>Haiti</b>	22.5	25.2	29.6	29.2
<b>Jamaica</b>	16.3	16.6	17.3	17.0
<b>St. Kitts and Nevis</b>	2.4	2.3	1.1	1.1
<b>St. Vincent &amp; the Grenadines</b>	6.0	5.5	0.2	5.3

Source: “Countries,” Federal Reserve Bank of St. Louis (FRED), <https://fred.stlouisfed.org/categories/32264>.

Although there was an earlier perception problem for the Caribbean as being a place offering “fun in the sun” tourism while simultaneously providing facilities for money launderers to carry out their trade, the days of free-wheeling financial fraud are generally over. AML/CFT rules and regulations have been widely implemented, and most governments have been active in the development of a regional body, the Caribbean Financial Action Task Force (CFATF), as well as active participants in cross-border investigations. CFATF focuses on the implementation of and compliance with AML/CFT standards across the region. Despite these advances, de-risking pressures were heavily felt from 2015-2018.

The risk of further de-risking exists. Indeed, in its 2018 Article IV report on Dominica, the International Monetary Fund (IMF) noted of risks facing the country de-risking.<sup>8</sup> In its Article IV report on St. Vincent and the Grenadines, the IMF stated, “Domestic risks include more severe and frequent natural disasters, the loss of correspondent banking relationships, and materialization of financial sector risks.” This was paired with the IMF commending progress made in addressing legal deficiencies in the AML/CFT framework.

Many in the Caribbean feel unfairly targeted. Manuel Orozco, a senior director at the Inter-American Dialogue, noted before the U.S. Congress in October 2018: “Many commercial banks in the Caribbean saw longstanding banking relationships terminated due to the perception that financial activity with the Caribbean is by definition high-risk. Rather than manage risk or assess banking partners on an individual basis, a blanket assessment is made and banking relationships are terminated.”

8. The IMF noted, “The risk of loss of correspondent banking relations (CBRSs) could affect the ability to make international payments and transfers.” IMF, *Dominica 2018 Article IV Consultation* (Washington, DC: August 2018), p. 10, <https://www.imf.org/en/Publications/CR/Issues/2018/09/05/Dominica-2018-Article-IV-Consultation-Press-Release-and-Staff-Report-46204>.

Orozco's comments were more recently echoed by Sir Ronald Sanders, ambassador of Antigua and Barbuda to the United States and the Organization for American States, who testified before the U.S. Congress in early-June 2019. He noted of de-risking, "And this grave threat has been hanging over the Caribbean now for almost half a decade, and it shows no sign of abating. Right now, in many parts of the Caribbean, the majority of banks are now reduced to having only one correspondent bank, and at an extremely high cost."<sup>9</sup>

A point of friction between the Caribbean and the advanced economy countries pushing de-risking is that the United States and others, which control the Organization for Economic Cooperation and Development (OECD), FATF, Financial Stability Board, and other international organizations, use the policymaking process to constantly impose new standards and then penalize small countries for not meeting the standards. This is made all the more irritating as many of the OECD countries, including the United States and United Kingdom, do not meet all of the new FATF standards, especially when it comes to better transparency and disclosure on ultimate beneficial owners of shell corporations.<sup>10</sup>

Indeed, the United States and United Kingdom are major destinations for money laundering and tax evasion, partially due to the ease of establishing limited liability companies without disclosing the beneficiaries.<sup>11</sup> Considering that the United States, United Kingdom, and other European countries often complain that Caribbean offshore financial centers promote tax evasion, the evidence of hot money entering advanced economies tends to rankle the Caribbean.

### *The "New Normal"*

By late-2019, it appears that the worst of de-risking is over, and it appears that the Caribbean has found a new normal with de-risking, which was suggested to the author by Toussant Boyce. The new normal is defined by restricted services, higher costs, and limited access to wholesale finance. Those countries most affected by de-risking are some of the smallest states in the Caribbean, where profitability is often the most challenged. Most of the international banks that wanted to leave have left, and at least one local institution, Republic Financial Holdings (RFL) Limited, from Trinidad and Tobago, has emerged as the regional bank active in a number of jurisdictions and capable of offering the services required for local businesses and individuals. RFL is the only regional bank not to be de-risked due to their robust AML standards.

But de-risking has not entirely faded as a risk for Caribbean economies, as reflected by the questions raised in Jamaica in August. Canada's Scotiabank is still actively seeking to offload most of its Caribbean assets. In July 2019, Antigua and Barbuda announced that they were in discussions to buy part or all of the Scotiabank operations in their country.

Antigua has also called for the creation of a Caribbean bank that would allow the region to counteract the position of international banks regarding correspondent banking. In the words of Antiguan Prime Minister

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9. Sir Ronald Sanders, "The US and the Caribbean: A Mutuality of Interests," Sir Ronald Sanders, June 6, 2019, <http://www.sirronald-sanders.com/viewarticle.aspx?ID=704>.

10. As one Washington-based U.S. international tax authority noted to the author in August 2019: "Since the Organization for Economic Cooperation and Development has downgraded ratings of the U.S. in terms of entity transparency, exchange of information, etc. and the U.S. refuses to sign the CRS (Common Reporting Standard) for banking, why are the U.S. and foreign banks not de-risking transactions with Nevada, South Dakota, Wyoming, and Delaware?"

11. As one article reported, "The U.S. is a popular destination for despots to deposit ill-gotten gains in large part because of its corporate registration system, or lack thereof. In America, corporate entities are created at the state level, and states have an economic incentive to make the registration process as quick and easy as possible. In Delaware, all it takes is \$90 and a one-page form with three questions (name of the entity, name of a registered agent and a mailing address or P.O. Box) to create an LLC. Library cards require more information." Jim Saska, "Bill Cracking Down on LLCs Used for Tax Evasion and Money Laundering Faces Obstacles," *Roll Call*, April 29, 2019, <https://www.rollcall.com/news/congress/widely-backed-bill-disclose-business-owners-faces-obstacles>.

Gaston Browne, such a bank would be “owned by various indigenous banks in the Caribbean and . . . would have branches in the US diaspora, UK diaspora and Canadian diaspora in order to provide services to the Caribbean in the diaspora.”<sup>12</sup> Although progress is being made in adjusting to de-risking in the Caribbean, it remains a point of concern, and more work needs to be done to create a more level playing field for small country economies dealing with larger countries and their financial systems.

While the Caribbean is being proactive in upgrading AML/CFT regimes, most jurisdictions have implemented recommendations from the CFATF. Respondent banks in the region have also been rerouting transactions through regional institutions. At the same time, global regulators and international standard setters—the Financial Action Task Force and OECD—need to address the complexity of regulations and risk exposures that are contributing to biases in the incentive structure against certain classes of business.

Caribbean countries should also consider greater use of fintech (financial technology) in the region to offset some of the downside risk from de-risking. In early 2019, the Eastern Caribbean Central Bank and Bitt Inc., a Barbados-based fintech company, signed a contract to conduct a blockchain-issued Central Bank Digital Currency pilot within the Eastern Caribbean Currency Union.<sup>13</sup>

What is the upside to using fintech? According to a 2019 IMF working paper, fintech can: (1) reduce transaction and services costs and foster financial inclusion and development; (2) enhance financial sector competition and improve intermediation; and (3) support growth and reduce poverty in the region by strengthening financial inclusion, development, and intermediation.<sup>14</sup>

The IMF study also noted with a particular reference to the Caribbean that “technologies such as mobile money might help increase financial inclusion for people living scattered across islands or remote areas.” Tied closely to de-risking, the IMF report also importantly stated, “Fintech can also help reduce the cost of remittances, an important source of income for many countries in Central America and the Caribbean—particularly given the loss of correspondent banking relationships.”

To be certain, fintech has its downside risks. These include the need for robust risk management systems for startup companies, the willingness of fintech managers to guard against criminal activities, corruption, and cyber risk. On cyber risk, the IMF warns: “Although cyber risks are not unique to fintech, increased connectivity and new entrants—that may not be subject to the same security systems—increase the entry points for cyber criminals and the potential for successful attacks.”<sup>15</sup> There remains much to be done throughout the Caribbean to increase cybersecurity, but fintech does offer a partial alternative to CBRs.

## *Strategic Considerations*

The Caribbean’s new normal leaves the region in a relatively precarious position. The worst is probably over, but the new status quo is one defined by tenuous linkages to the global financial system, which can leave trade, finance, and tourism at risk of being strangled. While money laundering and the financing of

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12. Peter Richards, “Antigua PM advocates need for Caribbean bank to deal with corresponding bank,” *Montserrat Reporter*, July 6, 2019, <https://www.themontserratreporter.com/antigua-pm-advocates-need-for-caribbean-bank-to-deal-with-corresponding-banking/>.

13. For more details, go the Eastern Caribbean Central Bank’s website: <https://www.eccb-centralbank.org/news/view/eccb-to-issue-worldas-first-blockchain-based-digital-currency>.

14. Pelin Berkmen et al., “Fintech in Latin America and the Caribbean: Stocktaking,” IMF, IMF Working Paper, March 2019, <https://www.imf.org/en/Publications/WP/Issues/2019/03/26/Fintech-in-Latin-America-and-the-Caribbean-Stocktaking-46677>.

15. Inutu Lukonga, “Fintech, Inclusive Growth and Cyber Risks: A Focus on the MENAP and CCA Regions,” IMF, IMF Working Paper, 2018, p. 3, <https://www.imf.org/~media/Files/Publications/WP/2018/wp18201.ashx>.

terrorism are serious problems that need to be addressed and guarded against, risk management can be more discerning.

It is in the interest of the United States to make certain that the Caribbean does not find itself locked out of legitimate global finance, a development that would most likely push the region to look for alternatives, such as China or Russia, which have their own systems of trade-related finance and correspondent banking systems. Considering the chill in U.S.-Chinese and U.S.-Russian relations and the efforts of those powers to expand their influence in the strategic backyard of the United States, more thought must be given to establishing some type of joint U.S.-Caribbean financial information clearing house to enhance the due diligence process in knowing one's customers. And then there is the related issue of Venezuela, which has created an international transnational criminal organization heavily involved in money laundering, drug and gold smuggling, and violence, some of which is known to transit through the Caribbean.<sup>16</sup> This has done little to reduce the perception of the Caribbean as a high-risk region for many international banks, despite local authorities' efforts to deter abuses from criminal organizations running out of Venezuela.

### *Concluding Thoughts*

In finance, the Caribbean's new normal is not optimal for the companies and individuals from the region nor for their trade and investment partners in advanced economies. The new normal is normal for now, but that can change, especially if there are more incentives to look for alternatives. Stronger efforts are required to make certain that the new normal does not become a long-term way of doing business.

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16. Douglas Farah and Caitlun Yates, "Maduro's Last Stand: Venezuela's Survival Through the Bolivarian Joint Criminal Enterprise," IBI Consultants, May 2019, [ibiconsultants.net\\_pdf/maduros-last-stand-final.publication-version.pdf](https://ibiconsultants.net_pdf/maduros-last-stand-final.publication-version.pdf).



*Scott B. MacDonald* is a non-resident senior associate at the Americas Program of the Center for Strategic and International Studies in Washington, D.C. and the chief economist at Smith's Research & Gratings.

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