**Financial Integrity Network Policy Alert:**
**De-Risking Compliance Challenges and Opportunities**

**Bottom Line:**

*As U.S. and European regulators have imposed significant fines on financial institutions for violating sanctions and anti-money laundering (AML) regulations over the past decade, many financial institutions have concluded that servicing high-risk clients and jurisdictions is simply not worth the reward. This increased regulatory risk has helped lead to "de-risking," a blunt reduction in exposure for financial institutions that also undermines efforts to maintain and increase legitimate financial inclusion. De-risking has not been uniform, and reconsideration of risk exposure cannot be explained solely by reactions to a more complicated and challenging financial crime and sanctions environment. Certain financial institutions have engaged in blunt de-risking to avoid the perils of potential fines and additional regulatory scrutiny, whereas others have not. Likewise, certain regulators have been more concerned with limiting such de-risking than others. Better understanding this landscape—and where it is headed—will help our clients and partners determine the best way to address the pressures to limit risk.*

## I. Introduction

In recent years, financial institutions have had to reassess their AML and sanctions risk exposure and management due in part to greater regulatory and enforcement scrutiny, seen most visibly in a wave of massive fines imposed on financial institutions for violating economic sanctions regulations and other financial crime laws. The decision by financial institutions, especially major global banks, to exit particular jurisdictions, business lines, and customer bases wholesale has created a perception of widespread "de-risking"—that is, the de-banking of classes of clients or transactions because they present particularly significant AML or sanctions risk.[1] This perceived trend of blunt de-risking has caused tension between the public policy goals of excluding illicit financial and criminal activity and actors from the financial system while expanding and ensuring financial inclusion for the sake of economic well-being. While continuing to demand greater adherence to AML and sanctions laws and regulations, U.S. and non-U.S. regulators and policymakers have also begun addressing concerns associated with blunt de-risking to avoid the

[1] Note that one of the core elements of the de-risking debate is the extent to which the de-banking of classes of clients or transactions—or the exiting of entire jurisdictions—because of the AML or sanctions risk is an overly aggressive response or simply appropriate risk management. While not trying to resolve this component of the debate, this policy alert more fully discusses this distinction below.

unintended consequences of financial exclusion.

This regulatory push and pull—threatening and imposing significant fines for AML and sanctions violations but discouraging the widespread de-banking of high-risk clients and transactions—can put significant pressure on financial institutions to develop robust compliance programs able to manage these risks.

The de-risking debate is more complex than this regulatory whiplash dynamic. While de-risking is occurring in some financial sectors, some financial institutions are actually increasing their operational presence in high-risk jurisdictions and with high-risk clients. This complexity poses challenges to financial institutions' ability to comply with relevant regulations and assure that they can manage their risk exposure—particularly relating to correspondent banking relationships (CBRs) with firms operating in high-risk markets—while also refraining from blunt de-risking. It also presents potential business opportunities to capture markets in need of financial services and access, particularly for those financial institutions with robust compliance processes and an ability to manage their AML and sanctions risk.

For public policy officials, there is an important balance to be drawn between the demands of the financial community to understand and manage its AML and sanctions-related risk and exposure effectively and the need for greater financial inclusion and access to capital and related services, especially in high-risk jurisdictions or at-risk populations. The absence of responsible financial institutions in high-risk markets or jurisdictions may deny not only access to dollar-clearing or other financial services but also may deny local markets and populations the benefit of the practices, policies, and culture of compliance that major global financial institutions are required to implement and export. This ongoing policy debate and how authorities and financial institutions respond will continue to impact the AML and sanctions risk environment as well as market decisions and opportunities.

This Financial Integrity Network (FIN) Policy Alert delineates key recent developments in this debate and offers our clients and partners guidance on what these developments will likely mean for their businesses and for this policy issue more generally.

## II. Background: De-Risking

The Financial Action Task Force (FATF) defines de-risking as "the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risk."[2] De-risking is often portrayed as banks cutting off broad swaths of the world from the financial system.

De-risking has been driven in large part by the increased regulatory pressure put on financial institutions following September 11$^{th}$, 2001. Since that time, regulators have imposed billions of dollars in fines on global financial institutions for violating economic sanctions regulations, prohibitions on terrorist financing, and laws related to financial crime more generally. Such fines

[2] http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2015/11/24/090224b083395501/3_0/Rendered/PDF/Withdraw0from000what0to0do0about0it.pdf

have, in certain circumstances, led directly to financial institutions exiting entire markets.

For example, in 2012, HSBC entered into a Deferred Prosecution Agreement with the Department of Justice and paid a $1.9 billion fine to the Office of Foreign Assets Control (OFAC) and other Treasury agencies for a number of AML and sanctions violations committed by its U.S. and Mexican branches. These violations included allowing drug cartels to move vast sums of cash over a period of years and wire millions of dollars. Following the fine, HSBC and other large banks such as Citigroup, Fifth Third Cincinnati, and JPMorgan Chase closed accounts along the U.S.-Mexico border and terminated CBRs with banks in Mexico that handled dollar clearing transactions or remittances. Bank officials reported fears of receiving similar fines for violations involving the clients of the partner banks.[3]

In countries and jurisdictions with strong AML and regulatory frameworks, taking reasonable steps to ensure the legitimacy of counterparties' clients can be relatively straightforward. However, in countries affected by war, political conflict, organized crime, or serious AML/CFT deficiencies, reliance on counterparties or local affiliates and appropriate due diligence is much more difficult to assure. Such challenges, coupled with intense enforcement and regulatory attention, have led banks to be particularly reluctant to do business in high-risk jurisdictions. For example, in May 2013 Barclays announced that it would terminate the accounts of Somali money transmitters, in large part because of the high risks associated with terrorist financing and money laundering in Somalia and East Africa.[4] This decision caused a significant policy and political uproar in the United Kingdom, as Barclays' decision to de-risk these Somali remitters effectively cut large, legitimate swaths of the Somali population off from the international financial system, exacerbated in an economy highly dependent of foreign remittances. It also spawned a court case against Barclays, which was settled in 2014 and showcased the tension between financial institutions' legitimate money laundering and terrorist financing concerns and the desire to ensure financial inclusion for populations even in higher risk jurisdictions.

As the Barclays example illustrates, financial institutions have been particularly cautious regarding the opening or maintenance of relationships with money service businesses (MSBs), often used to send remittances to foreign countries. The World Bank released a study in 2014 that surveyed government institutions, large banks, small/medium banks, and MSBs. It noted that MSBs across the world reported an increased trend of closed and/or restricted accounts between 2010 and 2014.[5] Global banks such as HSBC have ceased providing financial services to a number of high-risk jurisdictions, particularly in Africa. For instance, HSBC has exited from Algeria and has been shrinking its operations in Egypt.[6]

Similarly, banks within the United States have been sensitive to AML risks associated with MSBs and remittance companies. This is due in large part to recent enforcement actions by U.S.

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[3] https://next.ft.com/content/e2a0c59c-10f5-11e5-9bf8-00144feabdc0

[4] http://country.eiu.com/article.aspx?articleid=1671764951&Country=Somalia&topic=Economy&subtopic=Forecast&subsubtopic=External+sector

[5] http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2015/11/20/090224b0831efdaa/1_0/Rendered/PDF/Fact0finding0s00de0risking0surveys.pdf

[6] http://www.bloomberg.com/graphics/2016-global-banks/

regulators. For example, in 2015, the Treasury Department issued a warning to California Merchants Bank, the last national bank in the United States that sent remittances to Somalia, that its AML procedures were inadequate. As such, California Merchants terminated its relationships with Somali remitters.[7]

In general, this increased regulatory risk has sparked a significant reaction from international financial institutions, many of whom have felt perceived pressure from regulators to undertake Know Your Customer's Customer (KYCC) in addition to regular due diligence. This additional level of oversight and processing for each associated account increases the compliance costs for many financial institutions and often decreases the overall profit per account. As a result, many have concluded that it may not be worthwhile to continue relationships with certain high-risk clients.

## III. Not "Uniform" De-Risking

This narrative of broad de-risking is overly simplistic, however, and does not acknowledge the nuances within the financial sector's response to the changing regulatory environment. While de-risking is occurring, it is not occurring uniformly across all financial sectors and geographic locations. Indeed, the causes of de-risking are manifold, with AML, sanctions, and other factors such as market opportunity playing major roles in financial institutions' decisions to exit markets and customers. What may look like de-risking is often simply risk management, namely financial institutions reassessing and pricing risk and acting accordingly. To this point and as noted by then-director of OFAC Adam Szubin in October 2014, "the term [de-risking] is almost too broad. Because the appropriate compliance response is going to involve saying 'no,' to certain customers."[8]

De-risking has not manifested across all higher risk jurisdictions and financial sectors. A November 2015 World Bank analysis demonstrated that while there has been an absolute decline in CBRs, this decline has not been uniform across all regions.[9] In some jurisdictions, major international banks have almost completely closed their CBRs. As of July 2016, only two banks in the entire country of Belize maintain CBRs with U.S. banks needed to settle credit card payments and clear U.S. dollar-denominated transactions.[10] Since 2013, global banks ended 36 out of 75 CBRs in Liberia due to perceived risk and low volumes of transactions, whereas Angola currently has access to only one European bank for U.S. dollar-based CBRs.[11]

However, larger financial institutions in higher risk jurisdictions across the Caribbean, Latin America, Africa, Central Asia, and Europe have not been as impacted as smaller ones.[12] For example, a World Bank study conducted in 2016, found that large domestic banks in Colombia had not experienced a significant reduction in trade finance, remittances, U.S. dollar wire transfers,

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[7] See http://www.wsj.com/articles/account-closed-how-bank-de-risking-hurts-legitimate-customers-1439419093 and OCC enforcement http://www.occ.gov/static/enforcement-actions/ea2014-084.pdf

[8] https://risk.thomsonreuters.com/sites/default/files/GRC01606.pdf

[9] http://documents.worldbank.org/curated/en/113021467990964789/pdf/101098-revised-PUBLIC-CBR-Report-November-2015.pdf

[10] http://www.reuters.com/investigates/special-report/usa-banking-caribbean/?u

[11] http://www.imf.org/external/pubs/ft/sdn/2016/sdn1606.pdf, p. 15

[12] http://www.imf.org/external/pubs/ft/sdn/2016/sdn1606.pdf, p. 9

or liquidity lines. Even smaller financial institutions that reported a decline in CBRs have been able to find other CBRs with smaller and medium-sized correspondent banks.[13] Colombia in particular has spent considerable time and effort in developing a comprehensive risk based system that allows for adequate identification, control, and monitoring of AML and CFT-related risks. Likewise, while Money or Value Transfer Services and small and medium-sized domestic banks have been affected, other financial institutions have not been as significantly impacted by de-risking.[14]

Moreover, the causes of de-risking are manifold, and decisions that appear to be de-risking are often the result of other factors. In the United States, major financial institutions have been closing the accounts of a number of domestic banks primarily because of AML concerns. In 2015, Bank of America and Citigroup's Banamex closed branches on the border of U.S. and Mexico over concerns of potential threats of money laundering, in addition to closing accounts for individuals perceived to be high risk.[15] JPMorgan closed more than 100,000 accounts in 2014 and also closed numerous diplomatic accounts in 2011 on account of AML concerns.[16]

However, other recent instances of large banks closing accounts in high risk jurisdictions—often attributed to de-risking—are in fact due to other factors. For example, Barclays announced in March 2016, that it planned to sell down its 62% stake in Barclays Africa Group to 20% within the next three years.[17] This decision, while due in part to AML concerns, was also the result of the slowdown in the British financial institution's business in Africa more generally.[18]

Finally, what is often viewed as de-risking is simply appropriate risk management. In many instances of financial institutions exiting client relationships or jursidictions, the institutions have done a risk assessment and determined that the likely profit is offset by risk. These types of assessments are appropriate, yet they may be viewed by regulators and financial industry watchers as de-risking, as the end result is market exit. It is only when financial institutions are unable to properly price risk—and have de-banked types of clients wholesale or left markets as a result—that such dynamics unjustifiably undercut core objectives of the international financial system such as financial inclusion.

## IV. Regulatory Trend Lines

While regulators understand financial institutions' decisions to leave high-risk markets, de-risking has become an increasing source of concern among regulatory and enforcement agencies worldwide. While regulators originally focused on the threat de-risking posed to financial stability, in recent years they have turned their attention more fully to its impact on financial

[13] http://www.imf.org/external/pubs/ft/sdn/2016/sdn1606.pdf
[14] http://www.imf.org/external/pubs/ft/sdn/2016/sdn1606.pdf, p. 9
[15] http://www.wsj.com/articles/account-closed-how-bank-de-risking-hurts-legitimate-customers-1439419093
[16] See https://next.ft.com/content/e2a0c59c-10f5-11e5-9bf8-00144feabdc0, http://www.wsj.com/articles/account-closed-how-bank-de-risking-hurts-legitimate-customers-1439419093, and http://files.shareholder.com/downloads/ONE/559713616x0x820066/f831cad9-f0d8-4efc-9b68-f18ea184a1e8/JPMC-2014-AnnualReport.pdf
[17] http://www.forbes.com/sites/greatspeculations/2016/03/08/barclays-decision-to-exit-africa-and-slash-dividends-not-good-news-for-investors/#6c3c56d47827
[18] https://next.ft.com/content/01d64502-dca4-11e5-827d-4dfbe0213e07

inclusion and how to limit blunt de-risking.

Governments and international institutions, such as the World Bank and IMF, have cited greater financial inclusion as a way to encourage development and decrease economic instability. The goal for inclusive financial systems is to allow individuals and companies access to savings, investment in education and business opportunities, and the ability to better withstand financial shocks.[19] Additionally, for law enforcement agencies, financial inclusion allows for access to financial information that can be used to detect and stop criminal conduct.[20]

Internationally, FATF has focused on the de-risking issue and issued statements in October 2014, June 2015, and October 2015.[21] In these three statements, FATF attempts to clarify the risk-based approach with respect to CBRs, as well as to confirm that addressing de-risking is a priority and that FATF is continuing its work to clarify regulatory expectations. Fundamentally, FATF is concerned that de-risking could cause increased risk and opacity and force people into less regulated or unregulated channels. FATF further released risk-based approach reports on the banking sector in 2014, and on Money or Value Transfer Services in 2016, in an effort to provide guidance to financial institutions.[22]

Regulators such as the Financial Crime Enforcement Network (FinCEN) in the United States and the Financial Conduct Authority (FCA) in the United Kingdom have encouraged a risk-based approach in lieu of blunt de-risking. In 2014, Jennifer Shasky Calvery, then-Director of FinCEN, cited a joint guidance from FinCEN and the Federal Banking Agencies for banks to assess risks posed by providing services to MSBs in 2005, as a method to assess risks on a case-by-case basis.[23] Similarly, in November 2014, FinCEN issued a statement against the de-risking of MSBs and encouraging supervision rather than closing accounts.[24] In May 2016, FinCEN Deputy Director Jamal El-Hindi spoke regarding the importance of MSBs and the mechanisms available to properly monitor MSBs under AML legislation.[25] In particular he cited a white paper on MSB supervision and regulation issued by the Conference of State Bank Supervisors (CSBS) and the Money Transmitter Regulators Association (MTRA).[26]

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[19] http://siteresources.worldbank.org/EXTGLOBALFINREPORT/Resources/8816096-1361888425203/9062080-1364927957721/GFDR-2014_Complete_Report.pdf

[20] http://www.wsj.com/articles/more-than-ever-banks-play-the-role-of-government-law-enforcement-agents-1467883802. Beyond the goals of financial inclusion and better tracing of financial information, ensuring the presence of responsible global banking institutions in high-risk jurisdictions—and that they are providing services to high-risk client bases—can be positive for public policy, raising the standards in those markets and creating positive compliance externalities.

[21] See http://www.fatf-gafi.org/documents/news/rba-and-de-risking.html, http://www.fatf-gafi.org/documents/news/derisking-goes-beyond-amlcft.html, and http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-action-to-tackle-de-risking.html.

[22] See http://www.fatf-gafi.org/publications/fatfrecommendations/documents/risk-based-approach-banking-sector.html and http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-RBA-money-value-transfer-services.pdf

[23] See https://www.fincen.gov/news/speeches/remarks-jennifer-shasky-calvery-director-financial-crimes-enforcement-network-10 and https://www.fincen.gov/news_room/nr/pdf/20050426.pdf

[24] https://www.fincen.gov/news_room/nr/pdf/20141110.pdf

[25] https://www.fincen.gov/news/speeches/prepared-remarks-fincen-deputy-director-jamal-el-hindi-delivered-csbs-state-federal

[26] https://www.csbs.org/news/press-releases/pr2016/Pages/052416.aspx

Likewise, United States Comptroller of the Currency Thomas Curry suggested in a March 2016 speech that the Office of the Comptroller of the Currency (OCC) may produce guidance on appropriate risk in order to assuage financial institutions concerns of fines. He reiterated that banks have control over who they choose to do business with: "[i]nstitutions must make their own choice about whether to enter into or maintain a business relationship based on their own particular business objectives; their own evaluation of the risks associated with the particular products or services; and their own capacity to effectively manage those risks."[27]

In the same speech, Curry argued that the OCC may more stringently review decisions to exit clients and markets. Such statements could create additional pressure on banks to justify each client exit, limiting any attempts at blunt de-risking. In line with other U.S. regulators, Curry also emphasized that AML laws within host countries are vital for risk management and for the prevention of further account closures.

U.S. regulators are not alone. The U.K. FCA has been a vocal opponent of broad-brush de-risking.[28] In 2014, Sharon Campbell, then-FCA head of financial crime, stated the agency was "concerned" banks were using de-risking as a way to gain market advantage. The FCA has continued to advocate that "effective money-laundering risk management need not result in wholesale de-risking."[29] In addition to speeches and statements addressing the issue, the FCA commissioned a report on the drivers and impacts of de-risking in June 2015 and published the results in February 2016.[30] The report further strengthened the FCA's stance that "banks should not use AML as an excuse for closing accounts when they are closing them for other reasons."[31] In the same press release announcing the report, the FCA stated that upcoming legislation titled "Payment Accounts Regulations" *(SI 2015/2038)* will require some banks to offer basic payment accounts to individuals legally resident in the EU beginning September 18, 2016. It is unclear whether Brexit will affect the application of this law. The Reserve Bank of New Zealand has supported a similar stance that "banks' obligations under AML/CFT Act require measured risk management and do not justify blanket de-risking."[32]

In addition, certain governments have been cooperating to overcome challenges driving de-risking. For example, in the case of the United States and Mexico, both governments worked together to increase financial transparency, prevent money laundering, and limit de-risking. In particular, Mexican banks had been unable to respond to U.S. banks' requests for information due to Mexican law, resulting in U.S. banks filing suspicious transaction reports and terminating correspondent accounts. The Mexican government amended its Bank Secrecy Law, Data Privacy Law, and AML/CFT laws and created a legal mechanism by which Mexican banks could share information about their customers, as well as about their transactions. Such government-to-government cooperation will—to the extent feasible—likely continue.

Nevertheless, OFAC, FinCEN, OCC, FCA, Department of Justice, and other regulators have made

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[27] https://www.occ.treas.gov/news-issuances/speeches/2016/pub-speech-2016-25.pdf
[28] https://www.the-fca.org.uk/firms/money-laundering/derisking-managing-risk
[29] https://www.the-fca.org.uk/firms/money-laundering/derisking-managing-risk
[30] https://www.fca.org.uk/static/documents/research/drivers-impacts-of-derisking.pdf
[31] https://www.fca.org.uk/news/fca-research-into-the-issue-of-derisking
[32] http://www.rbnz.govt.nz/news/2015/01/statement-about-banks-closing-accounts-of-money-remitters

clear that they will remain vigilant for violations of AML and sanctions regulations. Regulators have publicly recognized that banks face the prospect of huge fines and reputational damage by continuing relationships in high-risk sectors or jurisdictions. With minimal guidance from regulators, banks will need to maintain heightened diligence of customers as the debate over de-risking continues.

## V. Business Concerns and Opportunities

Many financial institutions rightly feel they are suffering from regulatory whiplash. Banks have changed and applied policies to comply with AML and sanctions regulations as issued by financial regulators. However, they are now facing increased pressure from these same regulators to maintain relationships with high-risk customers or to justify existing those clients or markets. Yet this circumstance may present surprising business opportunities:

- For MSBs/holders of correspondent accounts who may be operating in higher risk jurisdictions, this provides the opportunity to demonstrate that—when adopting global standards for financial crime compliance—these entities pose little risk when compared to entities who have not adopted such standards. It is clear that FinCEN and other regulators are invested in ensuring MSBs continue to operate. In 2015, then-Acting Under Secretary Szubin emphasized how efficient reporting of MSBs has greatly assisted the Treasury Department in tracking illegal activities and organizations.[33] With guidance from FATF, and the FinCEN-approved white paper from CSBS and MTRA, there are opportunities for MSBs to demonstrate that they can be profitable clients with relatively low risk.

- For banks and other entities maintaining correspondent accounts on behalf of higher-risk entities, this focus on de-risking provides the opportunity to press for significant additional information—justified by the need to fulfill regulatory obligations—and address concerns they may have about customer risk.

- For those institutions with robust compliance processes, operating in underserved markets will be comparatively less risky: compliance safeguards will provide a competitive advantage. The current regulatory environment will likely remain in place for the near future. Institutions that adapt and maintain robust compliance processes will be able to manage risks effectively and thrive in emerging markets.

- New technologies may also mitigate many of the underlying concerns that have led to de-risking. As FIN Partners Juan Zarate and Chip Poncy have written, data aggregation, analysis, and monitoring tools—when combined with sophisticated compliance structures to include information sharing processes across institutions—will better enable financial institutions to evaluate underlying customer and product risks, and to effectively guard against illicit activity.[34] Those financial institutions able to take advantage of these advances will be uniquely positioned to effectively operate in markets where others cannot.

[33] https://www.treasury.gov/press-center/press-releases/Pages/jl9998.aspx

[34] See https://www.theclearinghouse.org/research/2016/2016-q3-banking-perspectives/a-new-aml-system

- For those institutions interested in doing business in high risk jurisdictions and with high risk clients, appropriate risk pricing may be a way to offset some of the concerns associated with elevated exposure. While this pricing idea has been suggested by a number of international organizations such as the International Monetary Fund,[35] it has not yet been adopted across the market. One way to potentially price such risk would be to analyze the additional cost of reinvesting in compliance to cover greater risk management concerns, while retaining a profitable margin that justifies sustaining or entering relationships in high risk markets. Better understanding and pricing such risk could facilitate those institutions with larger risk appetites to maintain certain clients, offer certain products, and remain in certain jurisdictions in ways that limit blunt de-risking.

- At a certain point, re-pricing to cover compliance costs may drive customer demand underground, putting pressure on authorities to both enforce regulation against the informal or unregulated financial service providers, and to potentially subsidize responsible compliance risk management in high risk / low income environments with vulnerable communities, such as in Somalia.

FIN will continue to work with clients to understand and address these derisking challenges, including by developing stronger risk management systems that earn the confidence of markets and regulatory authorities.

[35] https://www.imf.org/external/pubs/ft/sdn/2016/sdn1606.pdf