



PACIFIC ISLANDS FORUM SECRETARIAT

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FORUM ECONOMIC OFFICIALS MEETING

8 August 2023

FORUM ECONOMIC MINISTERS MEETING

9 - 10 August 2023

Suva, Fiji

AGENDA ITEM 6a: CORRESPONDENT BANKING RELATIONSHIP IN THE PACIFIC

Purpose

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This paper presents to FEMM the findings of the review of the withdrawal of correspondent banking relationship (CBR) in the region. The draft review report is attached as Annex 1.

Summary

In formulating a policy response to de-risking, or more broadly the de-banking problem, it is necessary to know (i) how serious the problem is; (ii) what impact de-banking has on the economy and society of each country; and (iii) why the problem has occurred. This review seeks an answer to all three questions. In addition, it summarises the initiatives that have been taken in some countries, and how effective they have been.

Drivers of de-banking are complex. Most decisions are driven by risk/reward considerations, and money laundering, financing terrorism and proliferation financing (ML/FT/PF) risk may play a direct or indirect role in some of those decisions. One of the major drivers of global de-risking is the increasing burden of compliance with AML/CFT regulations, together with the reputational risk involved when banks incur large fines and suffer the negative publicity and reputational risks that attend money laundering, terrorism and proliferation financing offenses. Changes in business strategies can also be relevant, and may be the dominant driver in relation to small jurisdictions and clients transacting in lower amounts.

This review entails a stocktake of correspondent bank relationship terminations affecting financial institutions in the following Pacific nations: Cook Islands, Fiji, French Polynesia, Kiribati, Nauru, New Caledonia, Niue, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu. As reasons for CBR terminations and those for refusing to establish new CBRs overlap, the study extends to the latter. It includes both an extensive literature review and an assembly of relevant data.

The analysis undertaken for this review shows that CBRs in the Pacific continue to decline in the region as a whole, although experiences differ for individual Pacific Island Countries. This decline of CBR is taking place against a general decline in CBRs globally over the past decade.

The stocktake analysis of the de-risking initiatives in the Pacific reflect the varied range of interventions and actions. While such interventions resulted in strengthened integrity frameworks and regulations, improved data collection and management, and better compliance and enforcement capacity, they have not had a clear impact on reversing the de-risking tide.

Given the wide range of interventions and improvements that are underway or are being explored in the Pacific, the recommendations below focus on measures that the Pacific Island Forum can undertake to support national action and strengthen the resilience of the region as a whole against de-risking.

A. Background

1. In August 2022, the Pacific Islands Forum Economic Ministers met in Vanuatu to exchange views on key economic issues and challenges affecting the region. The meeting took place in the context of a widespread COVID-19 outbreak in the region, as opposed to the easing of the pandemic in most of the world, as well as inflationary impact of the Russia-Ukraine war on the Pacific Islands.
2. Ministers recognized the potential negative impacts of losing CBR and expressed grave concerns regarding the de-risking of CBR, given its potential impact on accessible and affordable banking services in the region. Maintaining CBR is a prerequisite to attract investment, promote trade, and receive remittances. The meeting participants also noted the impact of losing CBR on the lives of Pacific Islanders, including seasonal workers, small and medium enterprises, and other vulnerable groups.
3. As an immediate action, the Secretariat engaged the World Bank, with the support of the Government of Australia and New Zealand, to conduct a study on the AML/CBR related issues in the region, with the aim of understanding the current situation in member countries, lessons learnt and potential remedial actions.

B. Key findings

4. A major reason often cited for withdrawal of banking services is de-risking in response to anti-money laundering, combating of financing of terrorism and combating of proliferation financing (AML/CFT/CPF) concerns. “De-risking”, in this context, is defined by the Financial Action Task Force (FATF), the global standard-setting body for AML/CFT/CPF as:

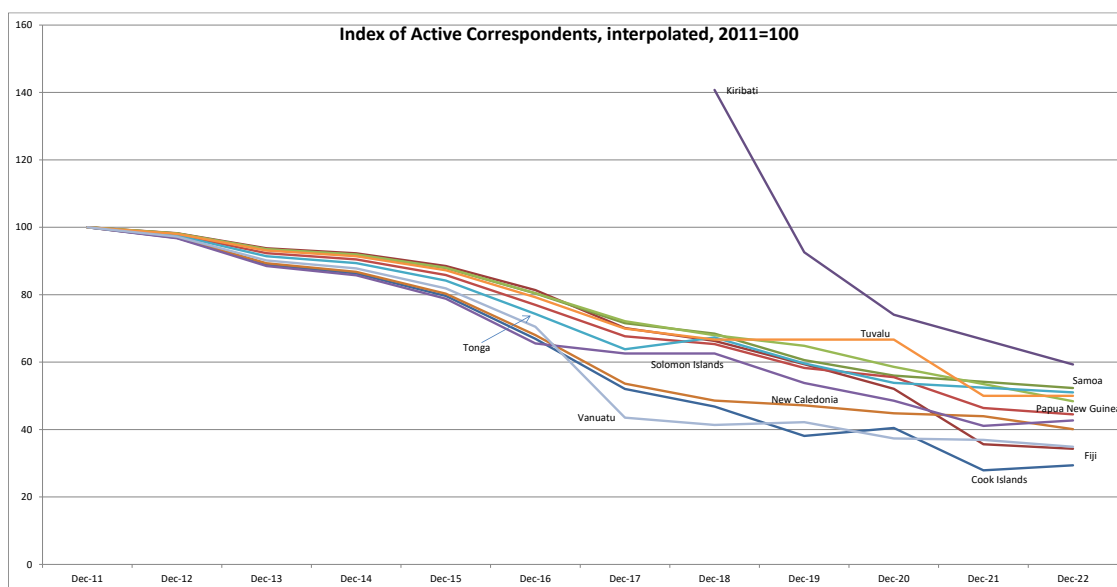
“the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risk in line with the FATF’s risk-based approach” (FATF 2014).

5. Perceptions of the level of money laundering, financing terrorism and proliferation financing (ML/FT/PF) risk in the Pacific depend significantly on the methodology employed to assess risk and, on the weight, given to the FATF-identified elements of “threat”, “vulnerability” and “consequences”.

6. Based on the FATF-standards, many Pacific jurisdictions are considered “vulnerable” to ML/FT/PF abuse as the levels of technical compliance with FATF-standards may be low and the levels of effectiveness of AML/CFT/CPF measures lag further behind.

7. The level of criminal threat in the region is lower than the norm. However, Pacific jurisdictions may be exploited as transit jurisdictions or to hide beneficial ownership.

8. Based on 2011-2022 SWIFT data for Fiji, Papua New Guinea, Samoa, Solomon Islands, Tonga and Vanuatu, there is a general pattern of CBR decline. This is shown in Figure 6 below:



Source: SWIFT Data, World Bank staff estimates

9. The impact of closure of CBRs in the Pacific can be demonstrated based on (i) the change in the number of counterparties abroad (ii) cross border transaction values and (iii) changes in the number of local banks. Based on 2011-2022 CPMI data, almost all countries have suffered significant reductions in CBRs, ranging from a decrease of 40% for Kiribati to a decrease of 70% for the Cook Islands.

10. Impact of decline of CBRs on exports - A strongly significant negative coefficient for the change in CBR was found, providing some evidence that the decline in CBR has had an impact on export performance.

11. Impact of decline of CBR on remittances costs - It shows that the observed decline in costs may be explained partly by a shift in the channels that are used to process remittance transfers, for example towards online and ‘mobile money’, and also by an increase in the market share of money transfer operators (MTOs).

C. Next Steps

12. That the proposed recommendations as outlined are implemented.

Pacific Islands Forum Secretariat
12 July 2023