

The Decline of Correspondent Banking in Pacific Island Countries

Technical Paper 2: Literature Review of Recommendations addressing de- banking and its impact

Contents

1. The development of solutions	2
2. Clustering initiatives.....	4
3. Improving ML/FT/PF risk management	6
3.1. Better regulation.....	7
3.2. Better AML/CFT/CPF capacity.....	8
4. Improving the enabling environment for CBR services	12
4.1. Supporting digital financial services (DFS)	12
4.2. Improving national infrastructure.....	13
4.3. Regional/shared or standardised solutions	14
5. Ideas not yet being actively explored in the Pacific.....	16
5.1 Improving ML/FT/PF risk management	16
5.2 Improving the enabling environment for CBR services	18
5.3 Countering the effects of de-banking	19
6. Effectiveness of proposals and barriers to achieving	20
6.1. Improving ML/FT/PF risk management	20
6.2. Improving the enabling environment for CBR services	22
6.3. Ideas not yet being actively explored in the Pacific.....	25

1. The development of solutions

Globally, risk-informed de-banking concerns reach back to 2001. In the wake of the 9/11 attacks global banks exited a significant number of correspondent banking relationships. In the US, banks responded to the concerns and new regulations by closing accounts of money services businesses, a group of cash-handling financial service businesses that include remittance service providers. The closures became so problematic that federal regulatory agencies issued a joint statement on 30 March 2005, acknowledging the problem (FinCEN 2005):

Money services businesses are losing access to banking services as a result of concerns about regulatory scrutiny, the risks presented by money services business accounts, and the costs and burdens associated with maintaining such accounts. Concerns may stem, in part, from a misperception of the requirements of the Bank Secrecy Act, and the erroneous view that money services businesses present a uniform and unacceptably high risk of money laundering or other illicit activity.

The statement acknowledged that the money services business industry provides valuable financial services, especially to individuals who may not have ready access to the formal banking sector. It called on banks to be more circumspect and promised improved guidance and regulation. While the supervisory actions stemmed the tide of closures, money services businesses continued to lose accounts (Bester et al 2008).

Closures of bank accounts of remittance service providers gained global attention in 2014. Public interest was sparked by concern about the closure by Barclays Bank of the account of Dahabshiil, an important international remittance service provider to Somalia. Barclays was the last large UK bank to provide services to Dahabshiil and the closure of its Barclays account threatened the continued flows of UK remittances to Somalia (British Bankers Association 2014; De Koker et al 2017). In October 2015 the UK government launched the Safer Corridor initiative to address the underlying concerns in the UK-Somalia remittance corridor (UK Government 2015).

Concerns about the impact of de-risking on correspondent banking relationships began to escalate in 2014. The Financial Stability Board ('FSB') expressed particular concern that banks terminating relationships with banks from higher risk countries was creating a real risk of some countries losing their access to the international financial system (FSB 2015). In 2016 the CPMI published its report on correspondent banking (CPMI 2016), with recommendations relating to:

- know-your-customer (KYC) utilities;
- use of the Legal Entity Identifier (LEI) in correspondent banking;
- information-sharing initiatives;
- payment messages; and
- use of the LEI as additional information in payment messages.

In 2016 the FSB, collaborating with the CPMI, FATF and other standard-setting bodies, adopted a four-point plan that entailed (FSB 2016):

- Further examining the dimensions and implications of the issue;
- Clarifying regulatory expectations, as a matter of priority, and including more guidance by the Financial Action Task Force (FATF);
- Domestic capacity-building in jurisdictions that are home to affected respondent banks; and
- Strengthening tools for due diligence by correspondent banks.

The FSB's four-point plan has since been subsumed into their joint project with standard-setting bodies and other stakeholders on improved cross-border payments.

In the past years a range of de-risking solutions have been proposed. The IFC in 2017, for example, recommended that the following actions should be considered (Starnes et al 2017):

Regulatory:

- Continuing to work toward achieving greater harmonization of regulatory requirements
- Maintaining appropriate regulatory capital requirements for short-term, low-risk lending supported by correspondent banking and adjusting Basel liquidity standards to take into account the operational nature of correspondent banking
- Enhancing support to emerging market regulators in developing compliance regulations

Financing:

- Providing additional capital and liquidity by investing directly in and with correspondent banks to sustain and/or expand their CBRs
- Encouraging multilateral organizations to innovate their product offerings to further support correspondent banking, particularly trade finance
- Providing additional funding and guidance to assist some emerging market banks in adapting their KYC systems and/or AML/CFT processes

Capacity building:

- Providing more training opportunities to emerging market banks to improve understanding and application of international and local compliance requirements
- Providing training to select emerging market banks' customers

Technological innovation:

- Supporting the development of central registries for respondent customer data and reconsider current liability standards for those who use it
- Supporting the development of national identity registries for KYC due diligence
- Promoting focused adoption of emerging technology-based solutions where relevant and secure

Knowledge sharing:

- Supporting appropriate information-sharing among institutions to enhance AML/CFT/KYC efforts
- Seeking enhanced opportunities for multilateral collaboration.

In addition to these de-risking recommendations a range of other, often partially overlapping, recommendations have been made by other bodies, including Not for Profit organisations (NPOs), and researchers (e.g. Eckert et al 2017, De Koker et al 2017, The World Bank Group 2018, US Government Accountability Office 2021, EBA 2022, Atlantic Council 2022. US Treasury 2023).

Identification of the actions that are intended to address de-banking is complicated by the range of factors that may directly or indirectly inform de-banking decisions. This report therefore focuses on actions that are generally viewed as directly linked to de-banking. It is however important to acknowledge that, in addition, a number of broader interventions to increase financial inclusion and develop enabling regulations and policies could also have a positive, though indirect, impact on CBRs. The UNCDF-led Pacific Financial Inclusion Programme (PFIP) that ended in 2020, for example, played a major role to assist the development of digital financial services in the Pacific (UNCD 2022). Two successor programmes - the Pacific Insurance and Climate Adaptation Programme (PICAP) and

the Pacific Digital Economy Programme (PDEP) - were launched in 2021. The PDEP program, a joint programme between UNCDF, UNDP and UNCTAD, also indirectly supports the further development of digital financial services in the Pacific (UNCTAD 2023).

The emphasis of this report falls on specific proposals made and/or initiatives investigated and/or implemented in relation to the Pacific countries that form the focus of this report, and developments that have been identified as particularly relevant to the Pacific.

2. Clustering initiatives

When looking at the range of initiatives proposed in response to de-banking, it is important to recognise that, just as there are several factors contributing to the scale and impact of de-banking, so there are a range of types of solutions, and no single solution will solve the problem for all countries, or indeed any individual country (IMF 2023, Department of Treasury 2023).

The Reserve Bank of New Zealand noted that recommendations for addressing de-banking have tended to be made along four key dimensions (Reserve Bank of New Zealand 2021):

- a) Better awareness, monitoring and information sharing
- b) Improving AML/CFT risk-management and know-your-customer (KYC) capabilities for respondent banks
- c) Clear articulation and enforcement of a risk-based approach to AML/CFT
- d) Development of technology-based solutions to support payments and remittance flows

The difficulty with this categorisation is that it is not exhaustive or mutually exclusive: technology-based solutions can contribute to other areas, such as KYC capabilities, some initiatives could fall into both b) and c) above, and it does not cover the de-banking that has occurred as a result of the reduction in financial viability of CBR services.

Becker proposed an alternative approach of classifying solution initiatives, one that differentiated countries according to two key drivers of CBR losses: the extent of AML/CFT risk and the commercial viability of providing CBR services (Becker 2023b). Thus, Becker identified a matrix with on two dimensions:

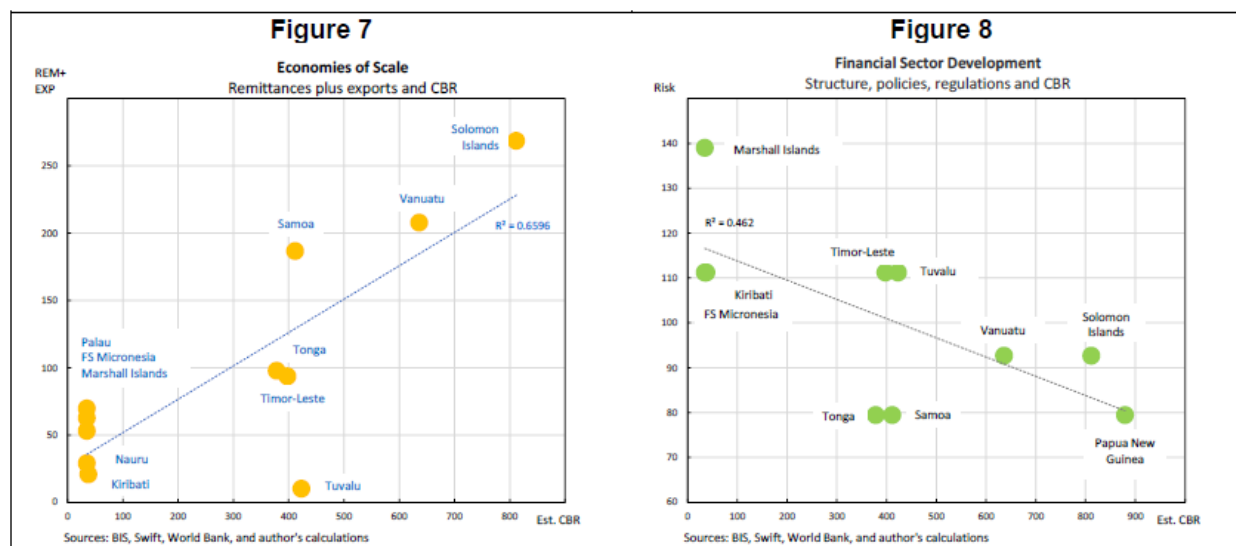
- **Low value versus high value transactions**, on the basis that low value transactions such as remittances tend to be much less vulnerable to AML/CFT risks. Conversely, countries with high value transactions are likely to be perceived as higher risk so that better/more transparent compliance activity becomes more important.
- **Low versus high existing connectivity** (i.e. number of existing CBRs). Low connectivity tends to be associated a lack of economies of scale and/or financial infrastructure. Notably, Becker found evidence that suggested that countries having limited economies of scale tend to be further disadvantaged by less robust financial sectors, as shown in [Figure 1](#) (which reproduces Figures 7 and 8 from Becker (Becker 2023b)).

Note however that the FATF acknowledges that low value transactions may hold lower ML risk but also that low value transactions may hold high TF risk.

In Figure 7, Becker relates the scale of cross- border transactions (as measured by remittances plus exports and shown on the left-hand axis) to the number of CBRs (shown on the bottom axis). The lines in the diagram are a simple regression line fitted to the data presented on the graphs. In Figure 8, the left-hand axis shows the level of strength of the financial sector (measured using World Bank

Development Indicators and with the scale inverted so that higher risk indicates weaker financial institutions). The bottom axis is the same as Figure 7, namely the estimated number of CBRs.

Figure 1: CBR relationship to economies of scale and financial development



Source: Becker 2023b

This report extends Becker’s approach, and categorises solution initiatives according to the nature of the driver of CBR losses the solution seeks to address. It also adds a category for solutions which seek to mitigate effects rather than seeking solutions to slow or reverse the decline in CBRs. Sub-headings aim to group the initiatives further into similar types of initiatives. This gives the following classification of solution initiatives, which is used to discuss the initiatives that are being undertaken or investigated by Pacific Island Forum members:

- a) Improving ML/FT/PF risk management
 - Better data
 - Better regulation
 - Better AML/CFT/CPF capacity
- b) Improving the enabling environment for CBR services
 - Supporting digital financial services
 - Improving national infrastructure
 - Improving the payments system
 - Adopting regional or shared solutions
- c) Countering the effects of loss of CBRs
- d) Ideas not yet being actively explored in the Pacific

The final category, “Ideas not yet being actively explored in the Pacific” includes recommendations that have been proposed in the international literature but have not yet been subject to active investigation in the Pacific.

A secondary level of classification is with whom the responsibility lies for implementing the solution initiative. Here the choices include the FATF, the Asia Pacific Group on Money Laundering (APG), other global institutions such as the IMF, Pacific Island governments/key institutions/regulatory

bodies, supra-national bodies such as the Pacific Island Forum, correspondent banks, local banks, other financial institutions including MTOs, and remitting clients such as NPOs.

Technological solutions clearly have an important role to play, but one that cuts across more than one classification. Accordingly, while technological solutions are identified, they do not form a classification as such.

Early discussion of recommendations focussed on the need to upgrade compliance, through a combination of upgrading supervisory frameworks and allaying the concerns of correspondent banks by improving domestic compliance with AML/CFT regulations (Alwazir et al 2017). In making these recommendations, the potential for technology to reduce the costs at the same time as improving the extent of compliance was recognised (World Bank 2018, Davidovic et al 2019). However, as de-banking has continued, and with the tendency of CBRs to fall faster and further in smaller nations, including the Pacific Island Forum members, policy recommendations were widened to include what measures can be taken to improve the commercial viability of providing CBR services and/or mitigate the effect on vulnerable countries/remitters (IMF Sep 2021, de Koker 2023). The FATF has also been giving consideration to how inappropriate responses to its standards may contribute to de-risking and other unintended consequences improved guidance and minor changes to recommendations that may prevent such outcomes (FATF 2022).

The remainder of this section provides a summary of the recommendations made in the international literature, grouped into the three categories identified above. Technical Paper 4 (TP 4) provides a stocktake of the initiatives being implemented or considered by Pacific Island Forum members.

3. Improving ML/FT/PF risk management

Better Data

Collecting data on CBR closures

CBR closures may lead to the use of informal money or value transfer services that may be vulnerable to ML/FT/PF abuse. In order to understand the extent of the problem, the FSB recommended that the World Bank and other global institutions collect information on the scale of CBR withdrawal and the impact on smaller jurisdictions. In turn, the World Bank encouraged national authorities to collect information on CBR closures at the country level, and to set up ongoing monitoring of CBRs in their jurisdictions (World Bank 2018).

The US Department of Treasury repeated this call for better data, noting that data on de-banking and loss of account access is often incomplete and laborious to collect. To this end Treasury has recommended that FinCEN and the Federal Banking Agencies scope out further data collection efforts (Department of Treasury 2023).

Improved collection of statistics

The IMF has emphasised the importance of improving the quality, timeliness and coverage of macroeconomic and financial statistics, and offered support through its Pacific Financial Technical Assistance Centre (IMF Aug 2022).

Improving regional dialogues/public-private risk information sharing

The Financial Action Task Force (FATF)'s risk-based approach assumes that regulated institutions can, with appropriate investment, have a sufficient level of understanding of ML/FT/PF risks to counter criminal abuse effectively and identify transactions that should be reported to national financial intelligence units. That has often not been the case, in part due to limited information-sharing about ML/FT/PF risk between government agencies and the private sector.

Since 2015 many countries established public-private partnerships to collaborate more closely with key regulated entities (Maxwell and Artingstall 2017) and to share sensitive crime intelligence. The UK, for example, established the Joint Money Laundering Intelligence Taskforce (JMLIT) in 2015 to enable financial sector institutions and law enforcement agencies to share and analyse information to combat money laundering (UK Home Office 2015). In 2017, Australia launched the Fintel Alliance, a public-private AML/CTF partnership between federal and state agencies and financial institutions, overseen and facilitated by AUSTRAC, the Australian financial intelligence unit (Chadderton and Norton 2019, AUSTRAC 2023b). The newly-established Pacific Financial Intelligence Community (PFIC) has 15 members, comprising regulators and FIUs, and is pursuing an active agenda (supported by AUSTRAC and the Reserve Bank of NZ).¹

To further advance understanding of AML risks by bank examiners, the US Treasury recommended that MSBs be allowed to share US federal and/or state examination results with their banking partners (Department of Treasury 2023).

While information-sharing partnerships and arrangements such as these face an array of regulatory and institutional barriers, it is argued that they can inform amendments to current approaches as well as the design of new, improved collaborative financial crime combating models (Maxwell 2020). Recent US Treasury consultations identified the importance of continued public-private sector engagement, and the Treasury has recommended the establishment and support of formal multi-stakeholder, public-private, domestic and international fora on the causes of de-banking, consequences and collaborative solutions (Department of Treasury 2023).

3.1. Better regulation

Enabling eKYC adoption and support for remote client onboarding

Electronic Know-your-Customer systems (eKYC) require appropriate national identification infrastructure, enabling systems and rules that allow the data to be accessed securely for eKYC purposes, as well as enabling regulations that allow the data to be used to meet AML/CTF identity verification requirements (Lyman et al 2019). See 3.2 below for more on KYC and eKYC utilities.

Simplified due diligence is appropriate where risks are lower, with tier-based CDD enabling easy access to basic services but access to enhanced transactional functionality only when higher identity verification thresholds are crossed. Both are potentially important solutions.

¹ Advice from AUSTRAC, 1 June 2023.

3.2. Better AML/CFT/CPF capacity

Capacity building of national agencies and bodies

Improving a country's compliance levels with the FATF standards has long been a priority. The World Bank summarised the requirements for jurisdictions as being to show strength, clarity and detail of its AML/CFT laws and regulations, rigorous enforcement by supervisory and law enforcement authorities, and the application of those laws by financial institutions. The World Bank also emphasised the importance of countries communicating such improvements (World Bank 2018).

Despite this, the US Department of Treasury identified that just 10% of countries have implemented effective AML/CFT supervisory measures, and that few countries apply a risk-based approach when supervising financial institutions. The Treasury recommended bilateral and multilateral push for strengthening the effective implementation of FATF standards, through FATF peer review process and FATF-style regional body mechanisms (Department of Treasury 2023).

Specific recommendations include (Department of Treasury 2023, World Bank 2018, Alwazir et al 2017):

- Consider regulations to require financial institutions to have reasonably designed and risk-based AML/CFT programs that are supervised on a risk basis
- Promoting consistent supervisory expectation through training
- Continuing to assess the opportunities, risks and challenges of innovative technologies for AML/CFT compliance solutions
- Increasing the frequency and intensity of onsite inspections of financial institutions
- Improved oversight of Money Transfer Operators (MTOs) in particular
- Increasing the scope and intensity of supervision of offshore sectors
- Strengthening the resources of central banks and Financial Intelligence Units (FIUs)
- Pursuing money laundering investigations and confiscation actions
- Upgrading sanctions regimes, to mitigate unintended economic, political and humanitarian impacts
- Upgrading of payments systems (see below)
- "Training for trainers" through AML/CFT specialists certification programs

Monitoring trends in correspondent banking relationships was seen as an important element of a supervisory regime, with the collection and analysis of bank data enabling authorities to understand vulnerabilities in their system (World Bank 2018).

Many donor organisations have implemented programs aimed at supporting countries in these tasks, and the US Department of Treasury has recommended that such assistance be bolstered (Department of Treasury 2023).

The development partners relevant to the Pacific include (World Bank 2018, Alwazir et al 2017, Becker 2023b):

- The Asia Pacific Group on Money Laundering (APG) provides a Mutual Evaluation Assessment, with Recommended Actions to improve AML/CFT systems
- The World Bank, IMF, Asian Development Bank (ADB), the International Finance Corporation (IFC), have all run programs which work with local authorities
- Reserve Bank of Australia, Reserve Bank of New Zealand and DFAT

Other resources available in the Pacific region include (Coyné 2022):

- The Pacific Transnational Crime Network and its Pacific Transnational Crime Coordination Centre (PTCCC)
- The Pacific/CFT Supervisors' Forum, which is supported by RBNZ.

Some aspects of the multilateral agencies' technical assistance to be noted in the Pacific includes the following:

1. The Legal Department of the IMF has access to CBR data for member countries.
2. The enabling of eKYC implementation to support remote onboarding is being considered as a possibility by all IMF member countries in the Pacific Islands, with a resource within the IMF's Pacific Financial Technical Assistance Centre (PFTAC) available to provide technical assistance.²
3. A resource within PFTAC is available to provide technical assistance on adopting appropriate Digital Financial Services regulation and strategies and this is being considered by all IMF member countries.³
4. The IMF hosted a workshop on CBDCs, prompting IMF member countries to consider their position on the possible implementation of CBDCs.⁴
5. The ADB has technical resources and is working closely with the Bank of PNG, Central Bank of Samoa, Central Bank of Solomon Islands, and Reserve Bank of Vanuatu and government agencies on key activities to improve KYC capacity. The work under this TA is closely aligned activities aimed at slowing down or halting the retreat of CBRs due to weak compliance capacity.⁵
6. The APG has delivered 11 virtual training courses on AML/CFT supervision to its Pacific members in 2021-2023. The courses have focused building AML/CFT supervisory capacity, particularly in relation to the banking and remittance sectors and offshore entities.⁶
7. AUSTRAC supports the Pacific Financial Intelligence Community, which comprises regulators and FIUs of 15 PI countries.⁷ In addition, AUSTRAC provides a large and diverse program of capacity building to financial intelligence units and AML regulators in the region. The program seeks to harden the Pacific's regional financial sector against ML/FT and to strengthen regional government's capacity to mitigate this risk and in turn support an enduring correspondent banking presence in the Pacific. Initiatives involve the delivery of theoretical training both virtually and in person, as well as experiential training through exchange programs and mentoring across both regulatory and intelligence streams.

National risk assessments

In accordance with the FATF standards the risk-based approach is a mandatory feature of national and institutional AML/CFT regimes, enabling efficient allocation of limited resources. Countries must identify, assess, understand and mitigate their ML/FT/PF risks and assess the criminal threats to country and the vulnerabilities of their AML/CFT/CPF system. These are generally referred to as a national risk assessment (NRA), though it may not be consolidated in a single document and in some cases a regional assessment may be undertaken. To assist jurisdictions with this task, the World

² Advice from IMF Department of Capital Markets May 2023.

³ Advice from IMF Department of Capital Markets May 2023.

⁴ Advice from IMF Department of Capital Markets May 2023.

⁵ Advice from ADB May 2023.

⁶ Advice from APG June 2023.

⁷ Advice from AUSTRAC June 2023.

Bank designed a specific tool, which has been used in more than 80 countries (World Bank 2018). The NRA must inform the shape and scope of key responses to the FATF standards. Financial institutions and other AML/CFT-regulated institutions could be required to undertake similar institutional risk assessments to determine the design of the AML/CFT risk control systems.

As discussed in TP 1, national risk assessments may not reflect risk levels accurately as they are often not informed by appropriate data, may use questionable methodologies, and may incorrectly assess key elements of FATF's risk concepts, especially consequences of a money laundering, terrorist financing or proliferation financing transaction.

Capacity building of local banks, MTOs and NPOs

The AML/CFT risk-based framework assumes that financial institutions are able to assess and mitigate the risks (de Koker 2023). Concerns regarding the lack of capacity amongst local financial institutions has led to donor partners providing training and other assistance.

A large part of the compliance burden relates to customer due diligence, which has prompted collaborative efforts to develop KYC utilities – discussed further below (GAO 2021). Guidance has been provided to MTOs on what is expected from them regarding AML/CFT compliance by a number of global institutions including the World Bank (World Bank 2018). Proposals for improved MTO procedures cover licensing/registration, customer due diligence, record keeping, the ability to trace transactions, reporting of suspicious transactions, and internal control systems (World Bank 2018).

Recently the GAO noted ongoing efforts to educate money service businesses on ways to minimise their terrorist financing risks (GAO 2021).

Efforts have been ongoing to educate NPOs on ways to reduce their ML/FT risks. Institutions such as the World Bank and the Federal Reserve have engaged with NPOs to understand their challenges and provide education on how to minimise their risks (GAO 2021).

Promotion of risk-based assessments/guidance to correspondent banks

International financial institutions, global financial standard setters and international development partners such as Basel Committee on Banking Supervision, CPMI, FATF, the IMF and the World Bank, have been at pains to encourage correspondent banks to manage the risks posed by correspondents and customers, and not simply to withdraw from countries or customers assessed as high risk (World Bank 2018, IMF Jan 2022).

In its 2021 report, the GAO identified the importance of guidance to banks on risk-based assessments. The report noted a series of guidance provided to banks by FinCEN, the Treasury Office of Terrorism and Financial Intelligence and federal banking regulators aimed at improving the transparency of risk-based approaches to bank examinations, dispelling the perception that banks will be criticized for taking on high risk customers when they are properly managing the risk, and encouraging innovative approaches to reduce the costs of due diligence. The GAO also cited examples of targeted training to bank examiners (GAO 2021).

Noting that banks are not currently subject to a regulatory requirement that their AML/CFT programs be risk based, the US Department of Treasury proposes that Section 6101(b) of the AML Act be implemented, to provide an opportunity for AML/CFT programs to be revised to become "effective, reasonably designed and risk based" (Department of Treasury 2023).

Improved national identity systems, including digital identity

Meeting customer identity verification requirements is a major challenge for countries with no or limited formal means of official identification such as driving licences or national IDs. Thus, processes for verifying the identity of customers, and assessing and monitoring customer risk, have been a focus of recommendations (Alwazir et al 2017, PIRI 2022).

National identification systems have to be improved. In addition, the growth in digital financial transactions requires a better understanding of how individuals are being identified and verified in the world of digital financial services. A robust digital ID can allow individuals without a traditional identification to nonetheless have a robust form of identification to access financial services and improve financial inclusion. The FATF developed a Digital ID Guidance to better understand digital ID systems and how to identify when they can support the risk-based approach to the CDD compliance framework (FATF 2020). In 2021, the World Bank, issued a digital ID Toolkit which includes policy considerations of digital ID and financial inclusion, building on the 2013 FATF guidance on financial inclusion (World Bank – FIGI 2021).

Building Block 8 of the FSB’s enhanced cross-border payment roadmap project, discussed further below, therefore envisages the improvement of the coverage, access, and quality of the official ID databases for individuals and legal entities; and fostering better alignment and cross-border recognition of identity requirements, customer due diligence requirements and the digital identity assurance frameworks and technical standards (FSB 2020).

Improvements are also being made at an entity level. SWIFT has also been working with high-risk jurisdictions to improve bank transparency using SWIFT’s KYC registry (Boulton and Winton 2018).

National KYC utilities

KYC utilities support customer due diligence measures by a group of AML/CFT-regulated institutions. These collaborative customer due diligence entities may be operated by the private sector, the public sector or by public-private partnerships (Lyman et al 2019). Such utilities can improve the quality identify verification and efficiency of KYC processes. When designed correctly, they do so while supporting privacy (Alwazir et al 2017).

Such utilities may also support institutional transaction monitoring, including monitors for fraud.

Most KYC utilities operate digitally and support digital financial services. They are therefore known as eKYC utilities. Various donor organisations are working with smaller countries, including in the Pacific Islands, to develop eKYC capability (PIRI 2022).

Having an appropriately-designed KYC utility, with information in a standardised format reduces compliance costs by taking advantage of economies of scale, and improves compliance quality by improving understanding of operations and risk management procedures (World Bank 2018, GAO 2021, Lyman et al 2019).

Building Block 8 of the FSB’s enhanced cross-border payment roadmap project is also relevant to national KYC utility. It envisages the implementation of shared or interoperable customer due diligence (CDD) infrastructure to allow financial institutions to access digital identity databases to meet their CDD obligations in a cost-effective way, domestically and on a cross-border basis (FSB 2020).

The GAO, however, has noted some limitations of KYC utilities, depending on their design. They can for example be costly to create and maintain, create privacy and data security concerns, and could undermine competition in the market by excluding organisations that are not able to link with the systems of the utility (GAO 2021).

Some of these concerns may be addressed by improved technology. KYC utilities can be decentralised using federated data mining approaches or blockchain technology, with the aim of improving transparency and efficiency. CordaKYC is an example of a blockchain-based decentralised KYC utility pilot project (Davidovic et al 2019).

4. Improving the enabling environment for CBR services

The recent review by the US Department of Treasury concluded that the primary factor in financial institutions' de-banking decisions was profitability. However, it noted also that profitability is influenced by a range of factors, including the financial institution's resources, the cost of AML/CFT compliance measures, and the potential for fines (Department of Treasury 2023).

4.1. Supporting digital financial services (DFS)

Adopting appropriate DFS regulation and strategies

At a BIS Innovation Hub Summit, the president of the French Competition Authority noted that regulatory authorities need to adopt innovation-enabling regulation. Failure by regulatory authorities to steer the direction of innovation will allow the private sector to take the initiative, with unpalatable outcomes for regulators and the general public (BIS Innovation Hub Mar 2023b).

Considering the role of Central Bank Digital Currencies (CBCDs)

There is a high level of interest in the potential role of CBCDs in payments technologies and digital currencies. A number of countries, including the Bahamas, Nigeria and the Eastern Caribbean have launched digital currencies, China is operating a large pilot project and the BIS is running trials with Korea, Germany and France, amongst others. A project conducted with the central banks of Israel, Norway and Sweden examined the benefits and challenges using retail CBCDs for cross-border payments (BIS Innovation Hub Mar 2023b). The operators involved are mostly central banks, although there is a privately operated experiment included (BIS Innovation Hub Feb 2023).

Kiffmeister reports that CBCDs are being/have been explored in some 93 jurisdictions while AiteNovarica reports that of over 100 banks involved in global payments, over half are either trailing a pilot or observing the market closely (Kiffmeister 2023, AiteNovarica 2023).

At a recent Innovation Summit, Christine Lagarde (President of the European Central Bank (ECB), explained the advantages of the proposed Digital Euro to include its contribution to:

- integrity, in terms of it being safe, sovereign, available to all and least cost
- resilience, in that it safeguards European autonomy
- integration, as available digital payment solutions are not pan-European

Other commentators have noted CBCD's potential for interoperability with other payment infrastructure, open participation, reduced credit risks and real-time settlement (BIS Innovation Hub Mar 2023b, de Koker 2023).

CBCD platforms are based on distributed ledger technology and can operate as a wholesale platform and/or as a retail platform. There are security advantages in operating a two-tier system (BIS Innovation Hub Mar 2023b).

However, many issues are still to be resolved, including legal and regulatory requirements, data analytics, privacy implications and cyber security (BIS Innovation Hub Mar 2023b). The IMF recommends that a cautious step-by-step approach is required if PI countries are to explore digital currencies effectively, and wondered whether a regional approach could help overcome capacity constraints (IMF Apr 2023).

Trailing appropriate products – eg mobile money/online services

Mobile money and other digital financial services (DFS) provide efficient means to increase usage of formal financial services nationally and cross-border. Increased usage of formal financial services improve CBR business cases, while DFS also allow for the adoption of technologies that can lower ML/FT/PF risk and AML/CFT/CPF costs in relation to DFS services.

Remittance services are termed “digital” if they are initiated online, either via online access to a bank account or via a mobile money service. Digital remittance services have proven to be cost competitive compared to bank transfers, and mobile initiatives such as the ANZ Pacific Money Transfer Card were implemented with the specific goal of reducing costs (Capal 2022, PIRI 2022).

The good coverage of mobile phones has made mobile money an attractive tool for widening access to financial services. Mobile money refers to customers’ funds stored by mobile network operators via pre-paid phone credit. It relies on the identification and security provided by SIM cards, and became popular first in the emerging economies of in Asia and East Africa (Alwazir et al 2017, Davidovic et al 2019).

Mobile money has grown in popularity in the Pacific over the last 10 years, with growth accelerating during the pandemic (Capal 2022). Mobile money services can be broadened beyond payments to allow savings accounts and banking services, including cross border mobile money transfers.

Mobile payments differ from mobile money, in that smartphone technology is combined with conventional bank accounts. Mobile payments also use the secure identification provided through SIM cards (Davidovic et al 2019).

4.2. Improving national infrastructure

National digital identity schemes

As discussed above, digital identity systems support eKYC utilities by both increasing the reliability of the verification measures and improving their efficiency (De Koker 2023). In the Pacific Islands, some 20% of the population is unregistered, which creates a significant cost burden for correspondent banks (PIRI 2022, Davidovic et al 2019).

Digital identification systems provide greater assurances to international banks as to who they are doing business with, and on the nature and adequacy of the identification measures being implemented by their business partners (PIRI 2022, IFC Jan 2018). The US Treasury noted that FinCEN is interested in how new digital identities can improve financial institution's ability to combat illicit finance and increase the efficiency and safety of customer identification data storage and processes (Department of Treasury 2023).

Digital identity systems need to be properly designed and supported by legislation and supervision. Two types of capacity assistance have been recommended for Pacific Island countries in this area (PIRI 2022):

- Assisting countries chose and adopt a trusted identity verification technology (one example being the Legal Entity Identifier or LEI)
- Assisting supervisors to understand how to use digital identity systems for eKYC and how to guide institutions in their jurisdictions in the use of the systems

The Brisbane Accord Group is a consortium of agencies which aims to coordinate partner support and maximise investments intended to improve civil registration and vital statistics in Pacific Island countries (Brisbane Accord Group 2023).

Upgrading national payments systems technology

The upgrading of national payment systems has been recommended as a means of reducing costs and support technical innovation (Alwazir et al 2017). National payments systems support local payments, inter-bank settlements and foreign exchange, so that improvements and efficiencies benefit both the country's financial sector and correspondent banks (PIRI 2022).

In some Pacific Island countries, cheque settlement services were organised by the central bank and in some cases undertaken manually. Moving to an electronic system greatly increases efficiency - reducing transaction times and costs for both local and correspondent banks (Davidovic et al 2019).

Increasing the usage of bank accounts and payment services

It is important to locate de-banking within national financial inclusion strategies. While steps are taken to improve access to financial services it is important to ensure that the services meet the needs of the majority of potential users. Widespread use of bank accounts and formal financial services increases the viability of a well-developed payment system and of continued correspondent banking services while supporting the effectiveness of AML/CFT/CPF measures.

4.3. Regional/shared or standardised solutions

The recent US Treasury report on de-risking concluded that one reason small foreign banks have difficulty maintaining CBRs is that the low volume of transactions does not generate enough profit to justify the costs (Department of Treasury 2023).

Regional/shared eKYC recognition schemes

A regional eKYC approach, with a standardised data format, and cross-border recognition can reduce the due diligence burden facing correspondent banks, as well as improve the quality of verification processes (IFC Jan 2018). On the other hand, regional implementation has significant up-front costs and requires adoption across a sufficient number of jurisdictions to reach an efficient scale (PIRI 2022).

The Reserve Bank of Australia and the Reserve Bank of New Zealand supported the Pacific Central Bank Governor's Forum as partners to investigate the establishment of a regional eKYC facility, aimed primarily at remittances (RBNZ 2022, Becker 2023). In June 2022 it was decided by the

participating banks that they would rather focus on the development of domestic eKYC utilities for the time being.⁸

The Governors of 9 Pacific Island countries agreed to continue to develop their eKYC capability on a national basis. They further agreed that regional eKYC collaboration may be considered as a possible extension of the national eKYC capabilities in the future.⁹ The likelihood and value of such a regional eKYC collaboration may be enhanced if such national developments occurred within an agreed regional standardisation framework that would e.g. facilitate cross-border recognition of national KYC enhancements.

Regional/shared remittance schemes/intermediaries

Given the importance of remittances for many Pacific Island countries, attention has focused particularly on the potential for regional remittance payments schemes to facilitate low-cost remittances to the Pacific. In 2007, the Reserve Bank of NZ led the New-Zealand Pacific Remittance Project which enabled low-cost remittances through ATMs and EFT at point-of-sale networks (Erbenova et al 2016). The more recent Reserve Bank of NZ initiative, the Pacific Remittances Project, was likewise aimed at improving access and reducing the cost of remittances to the South Pacific (RBNZ Feb 2022, RBNZ 2021).

As discussed further in the empirical section of the report, section 3 below, a number of fintech providers have developed remittance offerings. More recent examples include Wise and Choice Mauritius (IMF Mar 2023). These have been significantly cheaper than existing bank remittance services and appear to have placed downward pressure on the cost of remittance services generally (Capal 2022).

In most jurisdictions, however, payments systems can only be accessed by licensed banks. Removing existing legal and regulatory blocks that prevent non-bank payment service providers (PSPs) from accessing payments systems directly are likely to further reduce costs and increase competition (Wise 2022). An alternative is for the public sector to offer a service in conjunction with small remittance providers to address an imperfect market (IFC 2018). The Tonga development bank voucher system is an example of an attempt to do this.

Government or regional clearing agents

Another possible approach to improving the viability of correspondent banking services is to establish clearing agents, either within a jurisdiction or regionally. In the case where a jurisdiction faces severe loss of CBRs, a public-backed agent providing clearing services could step in (Alwazir et al 2017).

The GAO proposed that the US Federal government agency could play such a role particularly in high-risk countries, to ensure that humanitarian aid reaches countries where high ML/FT risks impede correspondent banking services. Such an agency could serve as an intermediate recipient of funds and assume responsibility for the distribution of said funds to the beneficiaries (GAO 2021).

⁸ <https://www.rba.gov.au/media-releases/2022/mr-22-18.html>

⁹ <https://www.rba.gov.au/media-releases/2022/mr-22-18.html>

The Crown Agents Bank provides an example of an international development-focused company that provides cross-border payment services to central and commercial banks. Crown Agents Bank developed out of an 18th century body conducting financial transactions for British colonies. During 20th century the work of Crown Agents Bank expanded beyond former British colonies. Prior to 1997, Crown Agents was a UK public statutory corporation, overseen by the British Ministry of Overseas Development. In 2016 Crown Agents Bank and Crown Agents Investment Management was sold to Helios Investment Partners, a private equity investing firm operating in Africa and based in London. Crown Agents Bank does not directly clear transactions in USD, but instead facilitates nested transactions which are mainly cleared through Citi Bank. The bank also provides guidance to local banks on what is required to meet compliance requirements and to pass assessments (Becker 2023a).

At a recent workshop¹⁰, a representative noted that the small scale of the Pacific Island market meant that providing clearing services for an individual jurisdiction was unlikely to be economically viable without government subsidy or building economies of scale through a regional clearing service (Becker 2023a).

Multilateral platforms

The CPMI describes a multilateral platform as a payment system for cross-border payments that is multi-jurisdictional by design. It is a flexible concept and substitute for or operate alongside traditional correspondent banking relationships or bilateral interlinking of domestic payment infrastructures (CPMI2023b). Multilateral platforms have also been raised in relation to digital money and CBDCs as they could enable both more traditional and digital payments. In a recent draft paper the IMF described the benefits in this regard as follows (IMF Apr 2023):

Considering the uncertainty of what type of digital money can be introduced in the PICs, it seems that the best long-term solution for addressing both domestic and cross-border payment challenges is that PICs join a multilateral and “multifunctional” platform. Such platform would allow PICs with different types of money and payment systems to join, i.e., both those with a national currency (and in the future a potential CBDC) and those without national currency (using either foreign currencies-based e-money or a sovereign issued stablecoin instead); both those with established national payment systems and those relying on foreign payment systems for clearing and settlement of transactions.

Depending on design, a multilateral platform can could reduce the costs and increase the safety, speed and transparency of cross-border payments (CPMI 2023b).

5. Ideas not yet being actively explored in the Pacific

5.1 Improving ML/FT/PF risk management

Provision of more Pacific ML/FT/PF risk data to inform improved risk assessments by international banks (e.g. corridor studies; country risk assessments)

Improved ML/FT/PF risk information in the form of country or corridor assessments that are provided by global entities can be very helpful in supporting the risk-based approach to AML/CFT. In

¹⁰ Crown Agents Bank Workshop on Correspondent Banking Relationship, held on 25 January 2023 in Washington DC.

particular, such assessments assist in encouraging banks to properly manage the risk, rather than unilaterally dismissing high-risk customers (Boulton and Winton 2018, GAO 2021). Similarly, the GAO noted that Bank Secrecy Act/AML risk-focused assessments and tailored examination plans conducted by federal banking agencies were helpful (GAO 2021).

Important work has been done on some remittance corridors in the Pacific, one example being a report by AUSTRAC, which was commissioned the Australian Department of Foreign Affairs and Trade (DFAT), which assessed the ML/FT risk associated with remittances sent from Australia to the South Pacific (AUSTRAC 2017). The report showed that these remittances posed low AML/CFT risks, however it has proved difficult to convey this to international banks (PIRI 2022, AUSTRAC 2017). Similarly, the New Zealand government conducted a New Zealand-to-Pacific Money Remittance Sub-sector risk assessment – money laundering and terrorism financing (New Zealand Department of Internal Affairs 2021). More such studies on other money flows, including flows from PIs to Australia and New Zealand, would be helpful. More effective co-ordination, or a regional risk management system, would facilitate the analysis of ML/FT trends across Pacific Island jurisdictions and the region as a whole, helping to create a clear view of the risks for correspondent banks (PIRI 2022).

More up-to-date information and data and on ML/FT/PF risks of Pacific jurisdictions are also required given that APG mutual evaluation reports may be dated and follow-up reports may not reflect improvements in effectiveness of AML/CFT/CPF regimes.

Consider correspondent banking safe harbour provisions for lower risk jurisdictions

“Safe harbour” provisions, in this context, refer to a range of measures that enable carve-outs or provide banks with legal protection where they engage certain customers or provide certain services deemed to be in the public interest. Safe harbours can similarly apply to countries in relation to compliance with international standards.

The FATF allows jurisdictions to exempt some institutions and industries from AML/CFT/PF obligations where they are proven low risk. This is more likely to be the case with certain customer groups than with CBRs but, given the interpretational and assessment challenges outlined in TP 1, requires further exploration. FATF also allows simplified due diligence measures if they support financial inclusion. However, many jurisdictions have not taken any advantage of these exemptions or adopted appropriate simplification regimes (Celik 2021).

In addition, concern that sanctions were hindering legitimate humanitarian activities led the US Office of Assets Control (OFAC) to issue new general licences, which expand upon humanitarian exemptions, exceptions and authorisations (GAO 2021).

Improved understanding of risk decisions by banks

Supervisory bodies have generally been hesitant to intervene in de-banking business decisions of banks. There are however compelling reasons for supervisory bodies to gain a greater understanding of the de-banking decisions of banks:

- Individual institutional de-banking decisions can displace criminal activity, thereby increasing the general crime risk to society (World Bank 2016). There is therefore a broader public interest in ensuring that de-banking decisions are reasonable.
- There is a risk that risk-related views and de-risking decisions are not appropriately informed, for example are biased or based on incorrect facts (US House of Representatives

Committee on Financial Services 2022). A review of decisions may inform corrective information-sharing strategies by supervisors, also internally.

- De-risking decisions may point to weaknesses in the risk management capacities of banks. It is important that supervisors have a good understanding of the risk management limitations of banks, and ensure that banks do not take on more risk than they are able to manage. Close scrutiny of the de-banking decisions of banks will support the supervisory oversight of banks' understanding and management of risk.

De-banking decisions should be taken in relation to customers individually. All steps and reasons should be documented and these documents should be available to supervisors to review (EBA 2023; AUSTRAC 2023).

Compliance codes of conduct for MTOs, NPOs

Recommendations have been made for global institutions or governments to develop a code of best practice to which money transmitters and NPOs could commit (World Bank 2018). Signed attestations that the money transmitter or NPO are following the code of conduct/best practices may provide some assurance to correspondent banks when they assess the risks posed by such a customer. Alternatively, there could be a system for optional certification, although smaller non-profits might struggle to pay for such a system. The GAO noted that some government endorsement of best practices would be necessary to give assurances to banks, but even then such measures were viewed as being of limited potential (GAO 2021).

5.2 Improving the enabling environment for CBR services

Plan for the Implementation of ISO 20022 messages for Swift cross-border payments and cash management messages

ISO 20022 is a standard for global open messaging which is designed to provide a common messaging language across banks and jurisdictions. The official implementation deadline for the standard is November 2025. Standardising the messaging format is expected to reduce costs, and the resultant high-quality data is expected to improve payment execution, transparency and reconciliation. There are challenges with the implementation of message standardisation, however, with fears that banks are seeking to create maintain customer loyalty by creating proprietary requirements through differentiation, overcoming internal processing requirement or decreasing interoperability (AiteNovarica 2023, Boulton and Winton 2018).

Recognising a legal right to a basic bank account and a legal right for payment service providers to access the payment system

It is increasingly difficult to operate in modern society without access to a basic payments account. An increasing number of countries are therefore recognising the legal right to a basic payments account. The right is generally not absolute but compels banks to provide reasons for refusal and termination of such accounts and customers with a right to have such decisions reviewed (De Koker at al 2017). Similarly, the Second European Payment Services Directive requires banks to provide payment institutions, such as remittance service providers, with non-discriminatory and proportionate access to payment account services (De Koker at al 2017). While measures such as these have not been without challenges (EBA 2022) they do potentially help to increase access to financial services.

Subsidized correspondent bank compliance costs

The option of using financial or reputational incentives to encourage commercial banks to provide CBR services in high-risk settings was considered by the Government Accountability Office (GAO). In the US context, such incentives could include tax credits or examination credit under the Community Reinvestment Act. The financial incentives would offset the higher compliance costs involved, and recognition for taking on the increased would balance the extra scrutiny (GAO 2021).

However, the GAO also noted the potential for unintended consequences to flow from such incentives: encouraging banks without strong AML/CFT programs providing banking services, creating market distortions and reduce the motivation of jurisdictions to lower their AML/CFT risk through improved compliance.

Harmonising regulations and practices to support intra-Pacific payments

An IFC survey asked banks what actions to address de-risking would be most valuable to emerging market institutions. Over three quarters of respondents said that harmonised AML/CFT/CPF regulations across jurisdictions would be helpful (IFC Jan 2018). The FATF standards provide a high level of global regulatory harmonisation but there are still significant variances in e.g. customer identification and verification measures.

Region-wide processes for settling payments seek to capitalise on economies of scale to further lower the costs involved in payments systems. Regional foreign exchange hubs/payments systems reduce the number and cost of due diligence tasks. They can improve the quality of payments systems, facilitate real-time settlement, improve the quality and quantity of data provided and in so doing enhance trust. Regional-wide schemes also make it easier to integrate new innovations and drive process improvements (PIRI 2022, Davidovic et al 2019).

The US Treasury intends to investigate the potential for regional “consolidation” respondent banking approaches, which could include the establishment of a publicly chartered corporation to consolidate regional financial flows. However, the Treasury noted the many challenges involved in this approach, including regulations, capitalization and ownership structure of the respondent banking customer (Department of Treasury 2023).

5.3 Countering the effects of de-banking

Contingency plans for de-banking

The World Bank recommended that national authorities should develop a contingency plan to deal with a severe loss of CBRs. The plan should consider how to prevent a systemic crisis in remittances as well as how to provide assistance to banks and MTOs that have been de-risked (World Bank 2018).

The World Bank also recommended that banks should have a de-risking contingency plan. The possibility of de-risking should be included in their risk management and recovery plans CBRs should be monitored continually and any withdrawal reported immediately to management. The contingency plan should also cover how the bank would carry on in the event of the loss of all CBRs, together with strategies for developing new relationship (World Bank 2018).

Another solution identified by the US Treasury is to find ways to support longer notice periods from correspondent banks. Thus, the Treasury recommended an additional inquiry be launched into bank

practices and processes and how such processes might be improved (Department of Treasury 2023). Consideration will also need to be given to compliance with FATF standards during such notice periods, especially appropriate risk management practices.

Modernisation of US sanctions

The US Treasury noted also that it is in the interests of US foreign policy for US government-funded or US government-partnered to have sufficient access to financial services. Thus, they recommended that US sanctions programs be modernised to facilitate humanitarian assistance (Department of Treasury 2023).

6. Effectiveness of proposals and barriers to achieving

As the discussion above shows, there has been much consideration of the problem of de-banking, and many recommendations have been made to address the problem. There is relatively little assessment in the existing literature, however, as to how effective the proposed solutions have been/are likely to be. Accordingly, this section of the paper draws together available evidence on how effective different recommendations have been/are likely to be, together with the barriers that have been identified that impede their implementation.

6.1. Improving ML/FT/PF risk management

Opinions appear to have divided in recent years on the relative importance of AML/CFT risks vis-à-vis commercial considerations as a key driver of de-banking. Thus, the Department of Treasury concluded that correlation between lack of potential profit and de-banking appears stronger than the correlation between AML/CFT compliance and de-banking. The Department noted that the primacy of profitability was confirmed in discussions with private sector banks, and that the most recent data on de-banking shows that low financial volumes and relatively low likely profitability is a more significant risk factor for de-banking than high illicit finance risk (Department of Treasury 2023). Similarly, analysis undertaken for the Federal Reserve Bank of Atlanta found “considerable evidence that contradicts the common, simple, story that locates the drivers of de-risking in the AML regime” (Nance et al 2021).

On the other hand, Bank of International Settlements (BIS) and other research suggests that AML/CFT concerns continue to contribute to de-risking (Department of Treasury 2023) and the IMF argues that it is imperative that Pacific Island countries pursue reforms to strengthen their AML/CFT regimes to mitigate the risk of losing CBRs (IMF Sept 2021).

Better Data

Collecting data on CBR closures

Following early recognition of the lack of high quality data, SWIFT, the Clearing House Interbank Payments System (CHIPS) and the BIS were asked to make available data on bilateral payment flows and the number of correspondent banking relationships between countries. SWIFT has made its data available to the Committee on Payments and Market Infrastructure (CPMI) and to the Financial Settlements Board (FSB), and FSB publish some breakdowns of the data but not the raw data itself due to confidentiality concerns. SWIFT also makes its data available to certain researchers upon

application, but with restrictions attached as to what can be reported publicly (Woodsome et al. 2018).

Despite the above, recommendations for improved data on CBR continue to be made (Department of Treasury 2023), and a 2021 study concluded that “The de-risking debate has a data problem ...” (Nance et al 2021). The experience of this study was that under the current arrangements, both the time taken to obtain approval for access to SWIFT data and the restrictions on what can be published served to restrict the analyses that could be undertaken, and impeded understanding of the current position of individual countries.

Improved collection of statistics

Improved collection of statistics and dissemination of risk management information was seen as a potentially high-impact solution by a recent Pacific Islands Regional Initiative (PIRI) study (PIRI 2022).

Improved regional dialogues/information flows

Dedicated frameworks to establish regular dialogues between those involved (competent authorities, the private sector and customer groups) have received increasing prominence in recent years. Thus, the European Banking Authority noted that many authorities across the EU are establishing multi-stakeholder dialogues (EBA 2022). The 2021 GAO Report considered that ongoing dialogue may help “clarify perspectives and potential solutions to banking access challenges” (GAO 2021). Similarly, the US Department of Treasury recommended “the establishment and support of formal multi-stakeholder, public-private, domestic and international fora on de-risking causal factors, consequences on categories of customers, and collaborative solutions” (Department of Treasury 2023).

The Atlantic Council considers relationship building to be a key element of the solution to de-risking, and in the context of the Caribbean recommends that the US Department of Treasury, Caribbean Governments and international financial institutions should consider hosting an annual forum that brings smaller jurisdictions and correspondent banks together (Atlantic Council 2022).

Better AML/CFT/CPF capacity

Capacity building of national agencies and bodies

Further capacity building remains a key recommendation. Thus, the US Department of Treasury recommends bolstering international engagement to strengthen the AML/CFT regimes of jurisdictions (Department of Treasury 2023) and the Atlantic Council has recommended that a range of US agencies work with Caribbean central and local banks to build technical capacity, knowledge sharing and data gathering to help the region comply with international standards (Atlantic Council 2022).

Nonetheless FATF reported that financial (and non-financial) supervisors are struggling to implement a risk-based approach effectively. In 2022, FATF noted that only 10% of countries have implemented effective AML/CFT measures (FATF 2022b). Concern that examination practices do not yet reflect the guidance and that additional action is required remains widespread (GAO 2021) and ongoing support to countries is seen as important (PIRI 2022).

Moreover, the lack of resources available in smaller countries is seen as a significant barrier. For very small countries, lack of progress is likely to reflect the lack of available domestic resources rather than any unwillingness to act (Atlantic Council 2022, Becker 2021).

National risk assessments

Questions have been raised over the ability of all, and particularly small, jurisdictions to implement national risk assessments successfully. A study covering eight financially sophisticated and systemically important countries found serious concerns over methodology, with a lack of conceptual clarity, limited data and a failure to explain methodology such that the goal of informing policy decisions was missed (Ferweda and Reuter 2022). With the revision to FATF standards, de Koker notes that the technical knowledge needed to identify relevant transactions and assess vulnerabilities is challenging small and large countries alike, including their regulated institutions (de Koker 2023).

Capacity building of local banks and MTOs

The GAO reported that while participants in their discussions considered proposals to help MTOs and non-profits improve their risk management as important, they did not feel they would be effective in improving bank access (GAO 2021).

Promotion of risk-based assessments/guidance to correspondent banks

The GAO reported that there are still perceptions of a lack of sufficient guidance as to what a risk-based approach is (GAO 2021) and ongoing support, particularly in the supervision of MTOs and designated non-financial businesses and professions, will remain crucial (PIRI 2022).

Improved CDD/KYC and National KYC utilities

KYC utilities are seen as a potentially effective tool, although their limitations have been noted. First, a KYC utility does not provide all the information required for the performance of bank due diligence – such as the legitimacy of a business or the source of money. Data security and privacy are also seen as concerns, particularly for eKYC systems that allow the sharing of information to third parties. In addition, the systems can be costly, and they have the potential to create problems of exclusion (GAO 2021, Woodsome et al 2018).

6.2. Improving the enabling environment for CBR services

It is important to recognise that de-banking remains primarily a business decision, subject to considerations of cost and risk versus profitability (World Bank 2018). Moreover, as discussed above, recent assessment of key drivers appears to be placing greater emphasis on lack of profitability (Department of Treasury 2023). This implies that measures aimed at improving the commercial viability of CBR services are likely to be increasingly effective.

Supporting digital financial services (DFS)

Adopting appropriate DFS regulation and strategies

Digital financial services hold the promise of cheaper financial services to a wider group of users, including those in remote locations. Improved regulatory support for appropriate digital financial

services can support financial inclusion and cheaper and more convenient remittances and payments.

Considering the role of Central Bank Digital Currencies (CBDCs)

The IMF has noted that while CCDs have great potential, their development requires considerable time and capacity, and that PI countries face considerable resource constraints in this regard (IMF Apr 2023). Thus, the IMF advises that countries considering issuing a CBCD need to have the appropriate legal authority and capacity to supervise CBCD activities, ensure that telecommunication and energy infrastructure is robust, strengthen cyber-security, and strengthen privacy and consumer protection regimes. The IMF has also raised concerns that CBCDs could create risks for macroeconomic and financial stability, given potential volatility of the digital currency and especially if associated with an off-shore digital economic zone, such as in the Marshall Islands (IMF Mar 2023, IMF May 2021, IMF Apr 2023).

The IMF's most recent report on digital money in the Pacific also notes that access to the necessary infrastructure (electricity, wireless, cellular and broadband technology) in most Pacific countries is lower than the world average, with connection expensive and unstable, impacted by natural disasters and lacking in resilience (IMF Apr 2023).

Improving national infrastructure

National digital identity schemes

Digital identity solutions are seen as a promising means of addressing de-risking by improving the efficiency and safety of customer identification processes and data storage. Moreover, they are seen as particularly beneficial for jurisdictions with weak AML/CFT frameworks and governance (Department of Treasury 2023).

While growing numbers of developing countries have implemented some form of KYC/eKYC utility, gaps remain particularly in low and lower-middle income countries. Meeting banks' customer identification requirements where there is no existing formal identity documentation is one barrier that has been identified, given that banks often require a range of documentary evidence. Privacy concerns are also an issue (Alliance for Financial Inclusion 2016, Woodsome et al 2018).

Upgrading national and cross-border payments systems

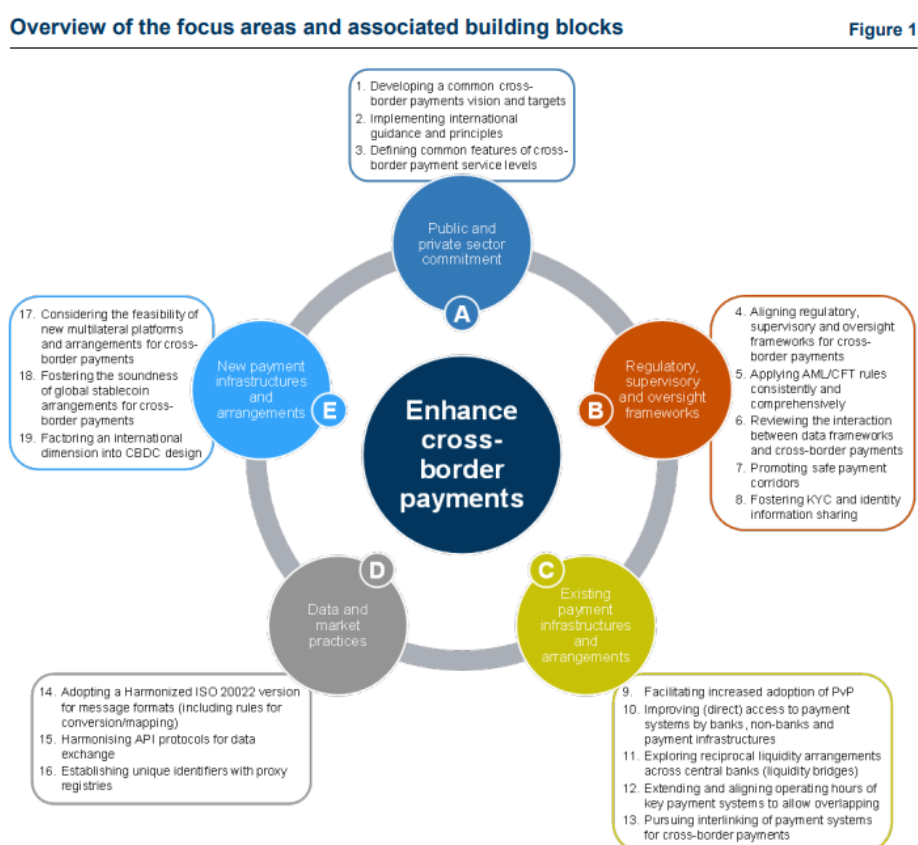
At the request of the G20, the Financial Stability Board has developed a roadmap to enhance cross-border payments (FSB 2020), in coordination with the Committee on Payments and Market Infrastructures and other relevant international organisations and standard-setting bodies, including the FATF. The roadmap with 19 building blocks is designed to address the main challenges identified to enable cross-border payments – high costs, low speed, limited access and insufficient transparency – and the frictions that contribute to those challenges. See [Figure 2](#) for the main focus areas and building blocks of the roadmap project.

A number of the building blocks hold particular relevance for the Pacific, e.g:

- Building Block 7 investigates safe payment corridors and encourages countries to implement safe payment corridors, focusing on establishing pilot risk assessments for likely lower ML/TF risk corridors.

- Building Block 8 addresses collaborative CDD. It is aimed at improving national identification systems, KYC utilities and cross-border recognition of national identity requirements and frameworks.
- Building Block 16 addresses the unique identifiers such as Legal Entity Identifiers (LEIs).
- Building Block 19 focuses on investigation of cross-border use of Central Bank Digital Currencies (CBDCs). Depending on design, CBDCs may address many of the frictions and inefficiencies in current CBR-reliant cross-border payment systems (Bank for International Settlements 2022).

Figure 2: Main focus areas and building blocks of the G20 Roadmap (reproduced from FSB 2022)



Source: CPMI: Enhancing cross-border payments: building blocks of a global roadmap - Stage 2 report to the G20 (July 2020)

The FSB roadmap now incorporates the FSB's work since 2015 to address de-risking and the decline in CBRs and financial access by remitters.

Regional/shared solutions

Regional eKYC recognition schemes

As noted above, the Pacific Central Bank Governor's Forum, with the Reserve Bank of Australia and the Reserve Bank of New Zealand, investigated the establishment of a regional eKYC facility. At the conclusion of the investigation, the PI jurisdictions involved decided that they preferred to progress KYC utilities on a national basis and that these may collaborate in future with regional counterparts. As mentioned in 4.3, the likelihood and value of such regional collaboration may be enhanced if such

national developments occurred within an agreed regional standardisation framework that could in future facilitate cross-border recognition of national KYC enhancements.

Regional remittance schemes/intermediaries

Methods of pooling transactions on a regional basis remain a focus of interest as a means of improving profitability. For example, the Atlantic Council has recommended that international financial institutions, such as the Inter-American Development Bank, The World Bank and/or the IMF should work with Caribbean governments to create a regional grouping or mechanism (Atlantic Council 2022).

The Department of Treasury is currently looking at regional “consolidation” of correspondent banking approaches, and has suggested that such an approach could encourage banks to take on correspondent relationships, provided it is structured appropriately (to address supervision, compliance and oversight considerations), and provided there is sufficient AML/CFT supervision from a credible regulator (Department of Treasury 2023). However, the Department also notes the many challenges, including regulations, capitalization and ownership structure of correspondent banking customers, and the need for transparency.

Government or regional clearing agents

The Marshall Islands provides an example of a country looking at establishing a government clearing house facility in Hawaii to enable direct access to the US financial system for cheque clearing and wire transfer services. The process is likely to be protracted given the approvals needed from various US authorities and the compliance requirements with US banking AML/CFT regulations (IMF 2018), and is likely to require US government intervention to facilitate the arrangements required (Korean et al 2022).

6.3. Ideas not yet being actively explored in the Pacific

a) Improving ML/FT/PF risk management

Improved understanding of risk assessments and de-banking decisions by banks

Risk decisions by banks reflect available risk information and assumptions about risk. The FATF advised that an improved understanding of bank risk assessments and de-banking decisions by supervisors can inform guidance where decisions are not appropriately aligned with risks.

Legal Entity Identifiers

The Global Legal Entity Identifier Foundation (GLEIF), established by the Financial Stability Board in 2014, provides the framework for the assignment and use of the Legal Entity Identifier (LEI). The LEI system focuses on providing a standardised identification and a centralised database from which information can be retrieved easily. The LEI (ISO standard 17442:2012) is a 20-digit alphanumeric reference code for the purpose of unambiguously identifying legal entities that engage in financial transactions. Each LEI is assigned to a unique legal entity and each legal entity may have only one LEI. Although the LEI system has not been designed to facilitate AML/CFT compliance in correspondent banking, BIS and CPMI advise that its use may bring some benefits in this area (CPMI 2016, BIS 2016).

To date about 2 million LEIs have been issued world-wide. Pacific regulators have not yet enforced the obtaining and use of LEIs and only a small number of entities in the Pacific have obtained LEIs.

Compliance codes of conduct for MTOs, NPOs

The GAO reported that stakeholders view codes of conduct and education initiatives for MTOs and non-profits as unlikely to be effective in addressing banking access challenges, although they may lead to some improvement in their risk management (AO 2021).

b) Improving the enabling environment for CBR services

Implementing ISO 20022 messages for SWIFT cross-border payments and cash management messages

ISO 20022 is a messaging standard that creates a richer common language for cross-border payment data globally, enabling faster and more efficient processing. From 2023-2025 SWIFT will be implementing ISO 20022 for cross border payments. SWIFT envisages that “by 2025, all reserve currency high-value payments systems (HVPS) will have fully transitioned to rich ISO 20022, and more than 90% of HVPS value worldwide will move on ISO 20022 rails” (SWIFT 2023).

Recognising a legal right to a basic bank account and a legal right for payment service providers to access the payment system

The European Banking Authority notes recognising the legal right to a basic bank account can create difficulties in finding the appropriate balance between financial inclusion and the application of AML/CFT requirements, and that financial institutions can choose to terminate an account on business grounds (EBA 2022).

Harmonising regulations and practices to support intra-Pacific payments

A recent FATF survey found that financial institutions find divergent AML/CFT requirements across jurisdictions (coupled with the lack of a risk-based approach) to be a major driver of cost (Department of Treasury 2023). Thus, standardising AML/CFT regulations and supervision is seen as a potentially important means of improving the financial viability of providing CBR services in the Pacific region (Becker 2021).

Subsidized correspondent bank compliance costs

Government subsidy to rectify a market failure, particularly where “public good” benefits are involved, is a well-accepted public policy response. For example, several governments have provided direct incentives to promote the use of regulated financial services, particularly digital ones, which have boosted the inflow of remittances through regulated channels (World Bank GPFI 2021). While financial incentives, such as tax credits offered by the US Government, could offset some of the compliance costs facing CBRs, several problems have been noted with subsidy arrangements. Unintended consequences could include banks without strong AML/CFT programs to start banking MTO’s, it could incentivize transfers to high-risk countries and reduce the motivation for improvements to compliance. There is also an issue in that some organisations will not benefit from tax credits as they are tax exempt (GAO 2021).

c) Countering the effects of complete de-banking

Contingency plans for extreme de-banking

The experience of the Marshall Islands shows the difficulty facing a country trying to develop contingency plans for dealing with extreme de-banking risks. Despite the fact that the Marshall Islands are authorised to use the USD as its legal tender, they have been left with a single CBR - First Hawaiian Bank (FWB) - for some time. Moreover, FHB has wanted to end its CB relationship since 2014, but has been prevailed upon to retain the relationship until the Marshall Islands find a replacement (Korean et al 2022, IMF 2018). The Bank of Guam (BOG), one of two licensed banks, has direct access to payment services of the US Federal Reserve system, but the bank has expressed concerns over the cost of AML/CFT regulatory compliance and there is no guarantee it will continue to maintain its presence in the Marshall Islands (Korean et al 2022).

Despite approaching other US banks, the Marshall Islands have so far failed to encourage any new CBRs, and FHB has now given final notice of its intention to end the relationship. As discussed above, the proposal to authorise a privately operated digital currency is on hold due regulatory concerns, and no progress has yet been made on the establishment of a Monetary Authority despite it being under discussion for many years. Furthermore, the Federal Reserve has indicated that it would not be able to provide banking services through Marshall Islands government account, so that a government-to-government agreement is needed to break the impasse (Korean et al 2022). Although the preparation of a wide-ranging financial development plan is underway, it faces many challenges and potentially short time frames.