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House Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

Tuesday, June 26, 2018

International and Domestic Implications of De-Risking

Chairman Luetkemeyer, Ranking Member Clay, and Members of the Subcommittee, thank you for the opportunity to appear before you today at this hearing on the "International and Domestic Implications of De-Risking". I am grateful to have the chance to address this issue, which has emerged as one of the most insidious threats to the Caribbean region's economic sustainability.

CCAA is not a financial association; we promote private sector-led development in the countries of the Caribbean and Central America with a specific focus on the U.S.-regional relationship. What we have seen in the countries of the Caribbean, is that de-risking is destabilizing economies, threatening trade, and creating security concerns that require constructive solutions sooner rather than later.

Understanding the impact of de-risking on the Caribbean is to understand how this phenomenon has impacted countries, industries, and individuals, so I would like to take a minute to describe some scenarios:

I will start with an example from the Cayman Islands. In 2015, on instruction from U.S. correspondent banks, the two Cayman Islands banks that provided accounts to money transfer businesses (MTBs) severed those relationships rather than risk losing their U.S. banking relationships. The MTBs, which provided critical services to people who send remittances to their families, were shut down. During the period that there were no MTB's, work-arounds had to be found to address the problem. This led to the now-infamous experience of one group moving cash in planes in order to make sure that the vulnerable population impacted by the termination had access to finance. One MTB was able to reopen a few months later, and today there is still only one MTB able to operate there.

Tourism is one of the Caribbean's most important industries. About four years ago I was talking to a leading Caribbean hotelier who shared that they had received a letter that morning from the U.S. bank that they had been using for about two decades. The letter essentially said: "As of today, we are no longer your bank". There was no valid explanation and no opportunity to address concerns and continue the relationship. In the tourism industry, most hotels want to have overseas accounts. It allows them to operate more efficiently as they can process credit cards directly with a U.S. bank, they can receive tour operator payments more seamlessly, and it cuts down on time to process transfers.

It is critical to note that the Caribbean tourism industry imports the majority of their goods and services from the U.S., contributing to the over $5 billion trade surplus that the US enjoys with the Caribbean. This is also the largest employer of people.

I spoke to that hotelier last week in preparation for this hearing to see how they resolved the issue. I was told that finding a new U.S. bank was "extremely difficult" and they still feel that the situation is precarious, at best. They did not want me to use their name, the hotel name, the name of the U.S. bank that they are now using, or even disclose the country or countries where they operate.

This last point underscores why getting a grip on the impact of de-risking in the Caribbean is so difficult. A legitimate business that has lost its U.S. banking relationships, regardless of whether there is any real risk present, has the stain of de-risking on them; so, they keep it quiet and hope that they will be able to replace the lost relationship. Bottom line: it's like fight club: The first rule of being de-risked is: you do not talk about being de-risked.

The toll has been highest on small and medium-sized businesses, where the costs of conducting transactions within the framework of the traditional banking system are becoming prohibitive. A lack of access to foreign exchange, rising fees for seemingly simple transactions such as wire transfers, and delays in payments and settlements have led to businesses moving outside of the system. We have seen a rise in cash and informal economies in some jurisdictions and the operation of parallel foreign exchange markets. Even for long-established businesses, the banking has become burdensome. One U.S. company that operates in the Caribbean reports that a process, such as opening a new account, that used to take ten days or so now can take 45-60 days and what used to be 3-4 sheets of paper can now add up to 40 pages or more.

The situation is volatile. The Caribbean Association of Banks (CAB) has indicated that among their membership, nine members have no U.S. correspondent banks, but instead have been onboarded by third parties to manage correspondent banking services.

Seventeen of their members have only one U.S. correspondent, leaving them vulnerable in the event of withdrawal. At the same time, the costs are rising. CAB membership has reported a 39% year-on-year increase in correspondent banking fees between 2014 and 2017, while the costs of compliance have increased approximately 66% on average during the same period. Furthermore, as relationships have been lost with U.S. banks, relationships are being sought in Asia and the Middle East, which can also be prohibitively expensive and difficult to manage. However, if the United States turns its back on the challenges of access to financial services in the Caribbean, there will be no option but to build relationships and prioritize trade with other countries.

HOW DID WE GET HERE?

This Committee is familiar with the sequence of events that led to the increased scrutiny of the financial sector. Rules were put in place to target money laundering, the trafficking of drugs, arms, and people, and the very real threat of terrorism. Compliance with the new rules became a significant cost center for all financial service providers, but smaller economies where the profit ratio is much tighter are particularly challenged. Sadly, the Caribbean also is seen as a high-risk region.

But while de-risking is a prime driver of the loss of banking relationships, the reality is that profitability plays a significant role as well. These are small economies in a global system and weighing perceived risk with profitability does not always work in the Caribbean's favor, even though the region has been working diligently to ensure that it is complying with the rules.

WHAT CAN BE DONE:

As the Sub-committee considers the testimony heard today, it is important to stress that no one is advocating for a removal of the rules. They were put in place for a reason and today's world requires that we build systems that have the capacity to recognize and eliminate threats. This should not, however, be done in a way that creates an environment that forces legitimate actors out of the system.

There are a number of tools that exist to help.

First, the United States Department of the Treasury continues to provide important assistance to the region to help it strengthen its compliance capacity. According to conversations with stakeholders, U.S. banks are provided with a certain comfort level when Treasury is actively providing technical assistance in these jurisdictions. More money could be allocated to the Department to help it work with the region, and, where possible, help the region acquire the technology that will strengthen its compliance profile. Another idea that has been proffered related to the Treasury Department: if we assume that larger banks are not going to go into the market simply because of the profit ratio, could there be a scenario wherein community and minority banks are encouraged to serve the Caribbean using the platforms within large banks, with the large banks who lend their platforms receiving credit under the Community Reinvestment Act (CRA)?

Second, the rules need to be consistent so that small countries with limited capacity aren't constantly struggling to stay compliant. To that end, there are new products emerging that will help countries and banks. Among these I would list the "Respondents Playbook" being developed by the Bankers Association for Finance and Trade (BAFT) which has seen de-risking affecting its members around the globe.

Third is the area of innovation, with new technology having the capacity to level the playing field. Companies are increasingly investing in technology and its applications, which could change the face of global financial access. This is happening in the Caribbean, where we have seen the emergence of companies like Bitt, Inc., a technology company out of Barbados with U.S. investors, which has become globally recognized in the area of digital currency and is working to remove financial friction points across the Caribbean.

Finally, I also believe that some consideration should be given to the issue of proportionality. Banks that have been caught violating the rules, have seen fines in the billions of dollars. One global bank has been fined approximately $21 billion over the past four years. Taken in context, a country such as Belize, which has been particularly affected by de-risking, had a GDP of just under $1.8 billion in 2016, along with $1.3 billion of external debt. If the application of the rules is weighted against small economies and their inherent vulnerabilities, how do we keep them viable?

Conclusion:

There are a few important points that I would like to close with. First and foremost: while it isn't commonly realized, taken as a group, the countries of the Caribbean and Central America are the fifth largest buyer of United States' non-oil exports, and in an era when U.S. trade deficits are a flashpoint for international discourse, as mentioned before, the U.S. consistently records a surplus with the Caribbean. In 2016, the total trade in goods with the countries of the Caribbean Basin Initiative (CBI) totaled $16.9 billion, of which the U.S. goods trade surplus was $6.1 billion, recording an increase in the surplus of 11.9% over the previous year[1]. This trade supports hundreds of thousands of jobs in the United

[1] Twelfth Report to Congress on the Operation of the Caribbean Basin Economic Recovery Act December 29, 2017. Prepared by the Office of the United States Trade Representative.

States and in the region. If access to banking is removed, or becomes more costly and difficult, it is likely that this healthy trade relationship will begin to be eroded.

Second, the countries of the Caribbean and Central America are the United States' Third Border. When the countries of the region experience instability, there are at least two potential outcomes if the problem isn't addressed. First, there is a risk of mass migration, much of which will be towards the United States. Second, is that the absence of the U.S. actively working to help the region address the problem, the door is opened to other partners who may be antithetical to the United States' security interests.

CCAA is grateful that this Subcommittee has provided a platform for the challenges to financial access in the Caribbean to be heard. Thank you, Mr. Chairman, for the opportunity to be with you today.