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S E R I E S

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## **Economic impact of de-risking on the Caribbean**

Case studies of Antigua and Barbuda,  
Belize and Saint Kitts and Nevis

Sheldon McLean  
Ydahlia Metzgen  
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UNITED NATIONS



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## Abstract

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Caribbean economies are open economies dependent upon international trade, foreign direct investment and remittances more so on average, than other countries. Small Caribbean countries, including the three countries that are the focus of this study, Belize, Saint Kitts and Nevis and Antigua and Barbuda are more open on average than the Caribbean as a region. This openness and integration into the global economy has conferred benefits in terms of increased growth and per capita income and reduced income inequality. Openness also exposes these economies to external shocks arising from changes in GDP growth of major trading partners, global recessions and financial crises. The most recent financial shock facing these economies is the loss of correspondent banking services (CBSs) and correspondent banking relationships (CBRs), referred to as “de-risking” in the region. The interaction of the quest for profits in a low interest rate environment with greater emphasis on country risk in a heightened regulatory environment since 2007 has created a “perfect storm” for developing countries including in the Caribbean that have pursued export-led growth and exposed their economies to the amplified vulnerabilities of openness.

This study examines the impact of de-risking on the study countries—bank and non-bank sectors. The study approach is based on survey instruments, consultations and analysis of secondary data. The impacts that have been observed, to date, have generally been discounted in most analysis as “anecdotal” and not valid for “reliable inference”<sup>1</sup>. However, in small economies such as those in this study what is anecdotal may be indeed reasonable for inference. The typically small number of banks as well as their dominance in the financial sectors of these small states suggests that reduced banking services will have knock on effects on other activities and sectors. In this regard, unlike most studies that cast a broad geographical net in attempting to assess the impact of the withdrawal of CBS, this study focuses on three countries which facilitates the “drilling down” and “zooming in” on the experience with de-risking.

De-risking as a financial shock has come to the study countries in the form of changes in relationships between correspondent bank and Caribbean respondent banks arising from regulatory pressures leading to reassessments of risk-reward trade-offs. It is acknowledged that correspondent

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<sup>1</sup> IMF (June 2016), p. 4.

banks providing services in the Caribbean region have (over)reacted<sup>2</sup> to regulatory guidance.<sup>3</sup> This guidance concerning customer due diligence and Know-Your-Customer's Customer (KYCC) requirements has led to reassessments of cost-benefit trade-offs associated with operating in these small economies. The perception of heightened risk as compared to low profitability associated with the small scale of business in the study countries has been the main driver of the de-risking of respondent banks by correspondent banks. Respondent banks, in turn, have reviewed risk profiles and, in the event, de-banked certain lines of businesses and customers.

The re-evaluation by global correspondent banks of risk-reward trade-offs in the study countries also have been fueled by misreporting on the state of AML-CFT frameworks and tax transparency for offshore financial sectors (OFCs). For the study countries, recent incorrect references in an official US government report<sup>4</sup> and on official websites linking the loss of CBRs to a laxity in money-laundering controls as well as outdated references to sanctions that have been lifted<sup>5</sup> have complicated national efforts in addressing de-risking. The false reporting and misrepresentation including by the news media in advanced economies<sup>6</sup> has served to underpin the risk-aversion of correspondent banks operating in these countries.

The international community has become increasingly aware of the implications of de-risking for transparency to the extent that de-risking might drive financial transactions into non-regulated channels. In this regard, concerned that de-risking could compromise the very transparency required for the fight against ML/TF, in October 2016 the FATF issued follow up guidance, clarifying that FATF recommendations do not require financial institutions to conduct customer due diligence on the customers of their customer.<sup>7</sup> However, it is unclear that correspondent banks will cease de-risking respondent banks in small countries like the study countries absent continued concerted advocacy by high level Caribbean officials and/or intervention by policymakers. In this regard, this study views de-risking as a financial shock that manifests overtime as a market failure in that the efficient and optimal allocation of banking services is not being provided. This, in turn, would call for intervention in the market by the national, regional and/or international public authorities to facilitate a more efficient outcome.

As concerns impacts, de-risking in the study countries has had a material impact on these banking sectors. The withdrawal of CBS is also eroding the access to financial services of businesses and households, and heightening economic uncertainty<sup>8</sup>. The analysis indicates that de-risking is leading to supply shocks via the channel of higher costs for financial services in all three countries though to different degrees. The withdrawal of CBS has also led to higher costs for the main sector in the study countries—tourism, at a time when these tourism sectors are under considerable stress. Moreover, the study results indicate that de-risking is also potentially threatening the existence of the OFCs, MTSP and in Belize, the Export Free Zones. Credit unions, the traditional provider of financial services to MSEs and small entrepreneurs are also stressed by the withdrawal of CBS.

<sup>2</sup> CGD (2015) and IMF, Belize Selected Issues (October 2016), Annex VI. Most large misconduct fines related to customer due diligence issues have been applied for breach of the U.S. sanctions framework. A survey of the largest penalties for customer due diligence-related breaches reveals that out of 24 fines of more than US\$100 million, all but one originated in the U.S. Under this category, most penalties involved egregious violations of economic and trade sanctions, with AML-CFT related penalties representing less than 20 percent of total.

<sup>3</sup> FATF gave guidance in June 2015 concerning the due diligence of customer's customers and KYCC.

<sup>4</sup> *US State Department, International Narcotics Control Strategy Report (INCSR), (2017), Volume 1, p. 151* and public response from Financial Services Regulatory Commission (FSRC)—Nevis Branch.

<sup>5</sup> See <https://www.state.gov/j/inl/rls/nrcrpt/2014/vol2/222688.htm>.

<sup>6</sup> See Economist, *Financial derisking Forget Whiter than white* and *Financial derisking. The great unbanking* Volume 424, Number 9048, July 8-14, 2017.

<sup>7</sup> FATF Guidance (October 2016), p. 5.

<sup>8</sup> Research by Cerda et. al. (April 2017) indicates that increases in economic uncertainty have negative effects over a small open economy even in the long-run. Estimates suggest that these impacts range from: 10 to 20 percent for aggregate investment and 1.3 to 4.2 for employment. Ghosal, V. and Ye, Y (January 2015) find that the effects of uncertainty on employment are primarily felt by relatively small entrepreneurial businesses.

Importantly, the detrimental “knock on effects” of economic uncertainty on economic growth—through delayed investments and hiring by businesses as well as reduced spending by households on a precautionary basis—will take time to manifest. Therein rests the “paradox of de-risking”: the spillover effects as well as macroeconomic consequences of de-risking are incipient; yet there is a need to take pre-emptive actions to avoid the manifestation of the potentially debilitating impacts before they are observable. In light of the paradox of de-risking, in addition to the vigilance and monitoring advised by international financial institutions<sup>9</sup> pre-emptive action akin to hurricane preparedness and response plans may be warranted. This action is important to avoid setbacks in the gains in financial intermediation and financial inclusion achieved in the study countries that are already evident.

The study suggests feasible short and medium-term approaches to addressing the challenges. The main short-term broad recommendations are as follows:

- Maintain close relationships with existing correspondent banks and respond effectively to requests for information.
- Financial institutions should join the SWIFT KYC Registry and other information sharing mechanisms to provide a compliance profile within the correspondent bank community.
- Enhance transparency via easy access to current and accurate information on regulatory frameworks, tax transparency and compliance with international standards to ensure information is available to those making decisions about involvement in a jurisdiction.
- Take pre-emptive actions against possible de-risking including by the preparation of de-risking preparedness and response plans. These plans should include scenarios which examine the implications for profits of increased interest rates in the resident countries of the correspondent banks providing services.
- “Ramp up” advocacy efforts at all levels to sensitize relevant actors that de-risking is a material financial shock with the potential economic impact on GDP akin to that of a hurricane shock.

Medium-term recommendations include:

- Launch a transparency and media campaign to address the misperceptions and misreporting on the regulatory frameworks and tax transparency of countries potentially vulnerable to de-risking. This includes fact checking the information available on foreign official websites.
- Consolidate banks and banking systems in the Caribbean to improve the profitability of providing CBS in small countries.
- Examine alternative strategies including the use of digital currency technology and currency substitution e.g. dollarization.
- Strengthen AML-CFT regimes so that they are “water tight” as these requirements evolve as a necessary but not sufficient requirement for maintaining CBRs. Secure greater representation in standard setting fora.
- Collaborate on advocacy initiatives targeting the most senior policy and executive levels to facilitate steps toward a more reasoned approach to the withdrawal of CBS from a jurisdiction.
- Undertake analysis to estimate the actual contribution of offshore financial sectors and export free zones to the economy.

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<sup>9</sup> See Sections III and IV.



There may indeed be valid reasons for correspondent banks to exit a jurisdiction where there are either valid AML-CFT risks and or/ low profitability. However, there needs to be a framework for fostering orderly work outs of the withdrawal of CBS and CBRs including policy interventions so that no jurisdiction remains without CBS given the link between the provision of these services, GDP growth and wellbeing. In light of the Sustainable Development Goals (SDGs), financial inclusion and access to international banking services is a basic human right for open economies like the study countries. The downside of inaction is a reversion to cash economies and informal channels for conducting trade and finance.

## I. Background

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Within recent years, specifically after the global financial crises (2007-2009) many regional and national banks have suffered the loss of the financial intermediation services customarily provided by international banks. In response to more stringent global financial regulations aimed at addressing the growing problems of money laundering and financing of terrorism (ML/TF) some international banks have withdrawn these correspondent banking services. Banks considered to be high risk and / or operating within high risk jurisdictions have been affected. In this regard The IMF 2016 study confirmed the Caribbean region as one of the region's most affected and as of May 2016 it reported that at least 16 banks in the Caribbean region across five countries had lost all or some of their CBRs<sup>10</sup>. The loss of correspondent banking services severely impacts the provision of key financial services on which individuals, businesses and government critically depend. This study, conducted on behalf of ECLAC, examines the nature of the problem and the impacts to date. To facilitate a more in depth examination the scope of the study was limited to case studies of three countries that are most affected by the withdrawal of CBS: Belize, St Kitts and Nevis and Antigua and Barbuda.

Two events at the global level appear to have triggered a response by the international community for strengthening the global financial regulatory infrastructure. The first is the 2007-2009 global financial crises which resulted in the build-up of systemic risks beginning in the US and then spreading to Europe and throughout the global financial system. The crises exposed the weaknesses in macro prudential financial supervision and regulation as well as the micro prudential regulations. The second event, which followed the crisis, was the increasing incidence of money laundering and the financing of terrorism activities using the banking system. In response the international community proposed stronger and more stringent regulations aimed at addressing the deficiencies and gaps in the financial regulatory system.

Given the central role of financial institutions in the movement of funds on behalf of money launderers and terrorism financiers, the new regulations introduced hefty penalties for violation. The result has been enforcement actions stacking up across the financial services industry with settlements up to USD 3.5 billion in 2012 from USD 26.6 MN in 2011 (ACAMS, 2014).

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<sup>10</sup> IMF (2016), p.13.

## **A. Responses to more stringent global regulations on anti-money laundering and combatting the financing of terrorism**

The new financial regulatory environment has thus triggered risk adverse responses from the financial institutions, globally. In particular, correspondent banks which execute and provide international banking services to local / regional banks, the respondent banks, have been re-assessing the continued provision of services to these local banks. This has resulted, in some cases, to the complete withdrawal of corresponding banking services to respondent banks or the cessation in the provision of certain specific services or services to specific clients. The low interest rate environment and high degree of liquidity in the US banking system, in particular, also triggered the reassessment of risk-reward trade-offs tipping the balance in favour of the withdrawal of CBS in low value and low volume jurisdictions<sup>11</sup>.

According to a 2015 World Bank correspondent banking/respondent banking survey, the Caribbean was among small jurisdictions with significant offshore banking activities perceived as “high risk” jurisdictions that have been adversely affected. A later IMF study (2016) confirmed the Caribbean region as one of the region’s most affected. As of May 2016, the IMF reported that at least 16 banks in the Caribbean region across five countries had lost all or some of their CBRs<sup>12</sup>. By October 2016, the findings of the survey of the Caribbean Association of Bankers (CAB) suggested that at least 21 respondent banks in 18 countries in the region were found to have lost at least one correspondent banking relationship<sup>13</sup>.

## **B. Vulnerability of Caribbean countries to the loss of correspondent banking relationships**

Caribbean economies are open economies, dependent upon international trade and remittances, more so, on average, than other countries (see figure 1). Trade in services is a key driver of economic growth and employment in small Caribbean economies in particular. The relatively high degree of openness of these economies with trade in goods and services at 93 per cent of GDP well above the global average (58 per cent) has conferred benefits to these economies though leaving them vulnerable (see figure 1).

With respect to the benefits to these economies from openness, one of the most important features of sustained and high growth is that it involves leveraging the demand and resources of the global economy. In this regard, research shows that “all cases of sustained high growth prominently include a growing export sector as a growth driver and rising fraction of GDP associated with exports and imports”<sup>14</sup>.

The higher dependence of Caribbean countries on not only trade, but also international financial flows with FDI (at 6.8 per cent of GDP in 2015) and remittances (at 4.6 per cent of GDP in 2015) each more than double the world averages as shares of GDP, suggests that Caribbean countries are highly vulnerable to a financial shock such as the withdrawal of correspondent banking services (CBS). In this regard, the study countries are more open on average than the Caribbean region as well as more dependent on FDI and remittance flows and hence more vulnerable to financial shocks.

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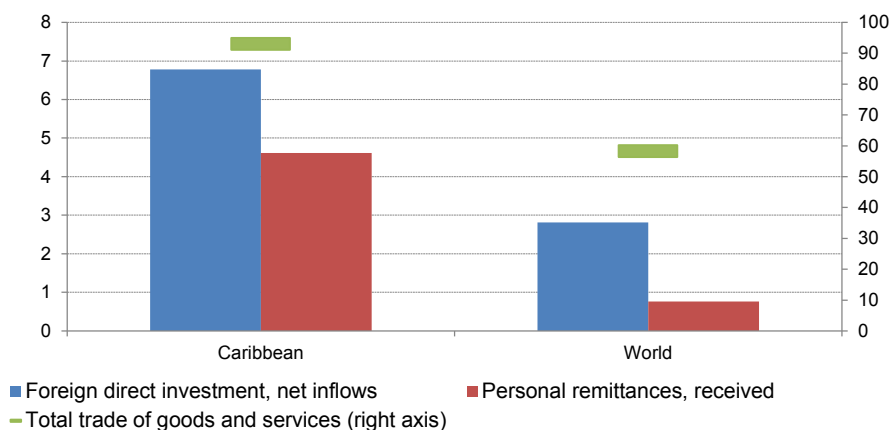
<sup>11</sup> With the excess US dollar liquidity and low interest rates pervasive post 2007 financial crisis there was little incentive on the part of US correspondent banks to hold onto the deposits of respondent banks.

<sup>12</sup> IMF (2016), p.13.

<sup>13</sup> CAB (October 2016), p. 7.

<sup>14</sup> Spence (2007).

**Figure 1**  
**Services dependent on correspondent banks, 2015**  
*(Percent of GDP)*



Source: World Bank.

Correspondent banking refers to domestic (Caribbean) banks maintaining relationships with “correspondent banks” in foreign territories in order to facilitate transactions and exchange currencies. These relationships allow access to foreign financial markets, and facilitate international financial transactions and trade including check clearing, letters of credits, wire transfer services and intermediary services. In this regard, correspondent banking can be broadly defined as the “provision of banking services by one bank (the correspondent bank) to another bank (the respondent bank).”

The withdrawal of CBS and of correspondent banking relationships (CBRs) from Caribbean countries is referred to as “**de-risking**”<sup>15</sup> in the Caribbean region. For the Caribbean given its openness and reliance on financial flows de-risking, de-marketing and de-banking (see box 1) are affecting trade flows, foreign direct investment, remittances and financial and financial aid. Correspondent banking relationships (CBRs) enable the provision of domestic and cross-border payments.<sup>16</sup>

For many domestic, international and offshore banks, correspondent relationships are crucial for their provision of cross-border services, including payments, foreign exchange and international trade. Furthermore, if a bank wants to settle a transaction in US dollars (or another foreign key currency), it is required to either be domiciled in a country hosting one of the few USD (foreign currency) clearinghouses in the world or it needs to bank with a correspondent in that country.

### C. Correspondent banks in the Caribbean

As of mid 2016, the main correspondent banks providing services in the Caribbean were domiciled in the United States, Canada and to a lesser extent Europe and the Caribbean<sup>17</sup>. Outward settlement of foreign currency electronic payments and financial instruments is extensive in the region. Reflecting the importance of the US as a trading partner in both goods and services with Caribbean countries, of the 60

<sup>15</sup> The use of the term “de-risking” characterized as indiscriminate (Erbenova, et. al., 2016) is the appropriate term for usage in the small economies which are the focus of this study where the withdrawal of correspondent banking services has mainly been driven by risk-reward assessments of the continuation of the provision of these services.

<sup>16</sup> FSB (2016), p. 1.

<sup>17</sup> WB Survey, 2015.

correspondent banks serving the Caribbean Region 43 per cent of these were US banks followed by European (38 per cent) and Canadian (15 per cent) banks (see figure 2)<sup>18</sup>.

### Box 1

#### Definitions: de-risking, de-marketing and de-banking

De-risking is a general phenomenon where an organization seeks to limit its exposure to risk by ceasing activities in a wholesale rather than a case-by-case fashion. For example, an international organization could de-risk by ceasing to operate in a region, such as the Caribbean, as a whole.

In the Caribbean, “De-risking” is also used in a more general sense, to refer broadly to the process of reducing exposure to risk in a jurisdiction.

De-marketing is the exit from a CBR and the provision of CBS solely on the basis of profit irrespective of market circumstances and the risk context.

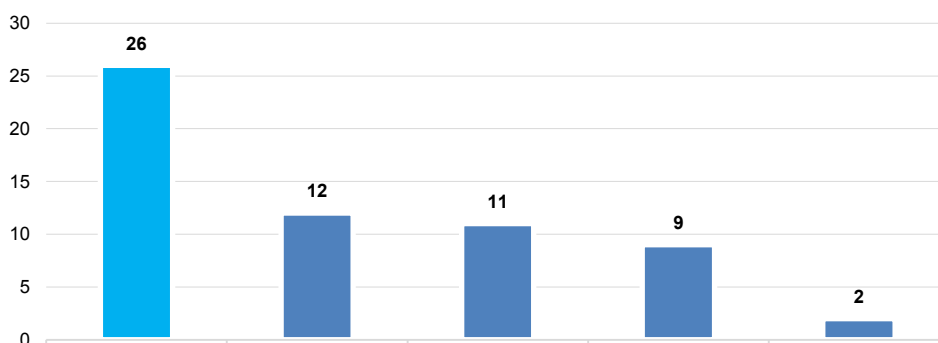
De-banking occurs when a bank unilaterally closes the account of an individual or institution. This could happen as a result of de-risking

Source: CGD (2015) and FATF (October 2016).

## D. Approach to the study

The objective of this study was to assess the actual and potential economic impact of the loss of correspondent banking services to the financial sectors in three Caribbean countries affected by the withdrawal of correspondent banks from their jurisdictions. Importantly, this report also discusses spillovers to other key areas of these economies, in particular, the tourism, financial services and productive sectors based on available data and information reported in the context of a survey instrument<sup>19</sup> and follow-up consultations with stakeholders in each of these countries. The study suggests feasible short and medium-term approaches to addressing the challenges associated with the loss of CBRs including the paths pursued by banks and policymakers in the study countries.

**Figure 2**  
Correspondent banks serving the Caribbean  
(2012)



Source: Caribbean Association of Banks.

<sup>18</sup> Responses by banks in the Caribbean region to a Caribbean Association of Banks (CAB) survey undertaken in August 2016 indicate that 73 per cent of respondents relied on the services of Bank of America and in the case of several small indigenous banks, Bank of America was the sole correspondent bank.

<sup>19</sup> The survey instrument was designed to go beyond the so-called “perception based” surveys and requested data quantifying the direct and indirect impacts of de-risking by respondents.

The timing of the withdrawal of CBS from each study country drives the comprehensiveness and meaningfulness of the analysis along with the availability of data for individual banks and for the banking system at large. Specifically, the relatively high survey response rates, greater participation in consultations and greater availability of published secondary data on Belize’s financial sector have facilitated a more in-depth and robust examination of the impact of de-risking on Belize’s bank and non-bank sectors.

## **E. Organization of the study**

This report is organized as follows: Section II provides an overview of the experience on the withdrawal of correspondent banks from the Caribbean region. Sections III to V present stakeholder feedback from the surveys / consultations in each of the countries with respect to experiences, including impacts of de-risking. Section VI advances short-term recommendations and medium-to-long-term recommendations which emerge from the survey and discussions to help address the withdrawal of correspondent banks from these countries and more broadly the Caribbean.



## II. De-risking: the Caribbean experience and impacts

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### A. Extent of loss of correspondent banking services in the Caribbean

The withdrawal of US correspondent banking services from jurisdictions in the Caribbean region has been acknowledged as a growing cause for concern among international institutions. Authorities in several Caribbean jurisdictions have reported particular pressures on correspondent banking services. The World Bank 2015 global survey of correspondent and respondent banking found that the Caribbean was among small jurisdictions with significant offshore banking activities perceived as “high risk” jurisdictions that have been adversely affected by the loss in CBS.

For the Region, it was observed that active correspondents have on average declined for the period 2012- 2015. As noted in Section 1, the IMF 2016 study confirmed the Caribbean region as one of the region’s most affected and as of May 2016 it reported that at least 16 banks in the Caribbean region across five countries had lost all or some of their CBRs<sup>20</sup>. By October 2016, the findings of the CAB’s survey suggested that at least 21 respondent banks in 18 countries in the Region were found to have lost at least one correspondent banking relationship.<sup>21</sup> Further, that US Banks followed by European banks were the most aggressive in terminating CBR services to banks in the Region.<sup>22</sup> The most affected lines of business reported by respondents were wire transfers followed by check clearing and cash letter deposits (see figure 3).

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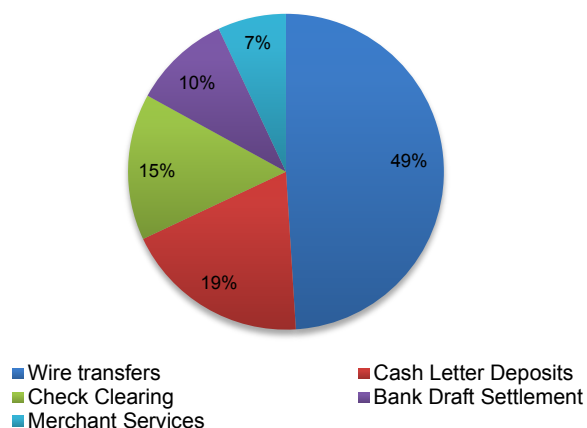
<sup>20</sup> IMF (2016), p.13.

<sup>21</sup> CAB (October 2016), p. 7.

<sup>22</sup> Correspondent Banking Survey, Summary of Findings, October 2016, p. 8.



**Figure 3**  
**Impact of de-risking on the provision of CBS to Caribbean banks**



Source: Author's calculations.

## B. Impacts from the loss of correspondent banking relationships in the Caribbean

While many of the banks in affected countries in the Caribbean region have established new CBRs and alternative options for basic international services, accessing these alternate arrangements are associated with significant additional costs, transaction delays and risks. In this regard three types of impacts associated with loss of CBRs are identified – primary impacts, indirect sectoral impacts and other indirect impacts. These are as follow:

- Primary / Direct Impacts:
  - Increased costs of banking services
  - Impact on human welfare & economic development given the Region's high dependence on financial flows
  - Adverse effects on initiatives aimed at alleviation of poverty & inequality. In the Caribbean and Central America remittance flows play key financing and stabilizing roles as they facilitate private consumption smoothing, support financial sector stability and help reduce poverty and inequality.<sup>23</sup>
- Indirect Impacts on Economic Sectors
  - **Tourism:** Given that most transactions in this sector are processed through credit card with correspondent banks, in turn, executing these transactions, the absence of these credit card services could negatively impact the viability and competitiveness of the tourism sectors of Caribbean countries
  - **Other Economic Sectors:** Increased pecuniary and non-pecuniary costs of doing business. An example of the former is an increase in fees while the latter includes additional documentation requirements, delays in executing transactions and longer time periods for transferring funds.

<sup>23</sup> Beaton et. al. (June 2017).

- **Access to Credit by MSEs (micro and small enterprises):** MSEs in the region rely on credit unions and local banks with stable connections to large international banks.<sup>24</sup> In the absence of these relationships MSEs which dominate economic activity in countries like Belize<sup>25</sup> lack the credit required to create jobs
- **Impact on Consumption for Households and Migrant Workers:** Households and migrant workers in the Region rely on money transfer service providers (MTSPs), for remittance inflows. MTSPs are now facing more expensive services and in many cases the denial and/or downgrading of banking services with potential implications for remittance inflows.
- **Other Indirect Impacts: Creation of Underground, Unregulated & Less Transparent Markets:** A major concern by the international community regarding the consequence of de-risking lies in the creation of underground, unregulated markets replacing the formal infrastructure to facilitate the movement of financial resources. In this regard, there is evidence in some countries in the Caribbean region, including one of the study countries, of the re-emergence and growth of informal markets for foreign exchange and trade. In addition, there is evidence of the use of less transparent mechanisms. In the long-term these impulses threaten not only transparency and the formal sectors of the affected countries, but also public safety and global stability.

### C. The drivers of de-risking in the Caribbean

What then are the main drivers that lead to the withdrawal of correspondent banking services? In the case of the Caribbean Region a common assessment of key studies is that there are two interacting factors in the main that explain CBR withdrawal. The first being business-related and the second, regulatory-related<sup>26</sup>.

**Business-related Drivers:** The small scale and low profitability of doing business in these countries when gauged against the perceptions of increased or excessive risks from operating in these jurisdictions in light of shifting regulatory requirements has led to a re-assessment by CBs of their business model for providing corresponding banking services in the Region.

**Regulatory & Risk-related Drivers:** Increased compliance costs for US correspondent banks in light of AML/CFT international/ regional sanctions and the large fines<sup>27</sup> that the banking industry has experienced since the passing of the US Dodd-Frank Act in 2010. Data from Boston Consulting Group (BCG) indicate that globally, banks have paid \$321 billion in fines since 2008 for an abundance of regulatory failings from money laundering to market manipulation and terrorist financing.

### D. Response to the de-risking in the Caribbean

Caribbean responses to de-risking have been on several fronts - at national, regional and international levels. The following are the main initiatives to date:

<sup>24</sup> CGD (2015), p. viii.

<sup>25</sup> A 2016 Business Establishment Survey of more than 4,100 business indicates that three-quarters of businesses reported earnings of US\$37,500 or less for the year 2014 and 90 per cent of the businesses participating in the survey had 10 or fewer employees at the time of the survey.

<sup>26</sup> IMF (June 2016), Section III and Commonwealth (2016), p. 9.

<sup>27</sup> According to the report data from Boston Consulting Group, banks globally have paid \$321 billion in fines since 2008 for an abundance of regulatory failings from money laundering to market manipulation and terrorist financing. Out of 24 fines of more than US\$100 million associated with customer due-diligence related braches, all but one originated in the U.S. To date US banks have not paid fines related to providing banking services in the Caribbean.

#### National / Regional Level Actions:

- **The Search for New CBRs:** Bankers in the region are proactively prospecting new CBRs armed with evidence of strengthened AML-CFT compliance frameworks, challenging the misperceptions and inaccuracies concerning the level of risk associated with operating in Caribbean jurisdictions
- **Action by High Level Officials:** High level national authorities including Prime Ministers<sup>28</sup> in the region have also proactively reached out to high level US regulators and politicians in order to raise awareness concerning actual and potential impacts on de-risking on Caribbean economies.
- **Regional / International Institutions:** Actions have been pursued by Caribbean regional bodies including CARICOM, the CDB, UN ECLAC and the CAB.<sup>29</sup> For example at a CARICOM Inter-Sessional Meeting of the Heads of Government held in Belize in October 2016, the following decisions (inter alia) were taken:
  - Strong ongoing lobbying activity by Heads in major capitals
  - Encouraging domestic banks to join the SWIFT KYC portal
  - Raising the awareness of adopting AML/CFT standards for all financial institutions
  - Consolidation of domestic banks
  - Possible establishment of clearing banks in major capitals.
- **Other Advocacy Initiatives:** UN ECLAC, the Caribbean Development Bank (CDB) and the ECCB are among the regional financial institutions that have offered to work along with CARICOM on advocacy efforts.

International Level Actions: At the international level, in response to concerns of member countries, the Commonwealth Secretariat has initiated several surveys and prepared reports on the impact of de-risking on Commonwealth members.<sup>30</sup> In addition, the World Bank Group investigated the impact of commercial banks' actions on non-bank international remittance service providers at the request of the G20 Global Partnership for Financial Inclusion.

## E. Outlook

The dynamics of international banking suggests that the profitability and regulatory features of providing correspondent banking services to the Caribbean are not likely to change over the short-to-medium term. As interest rates increase in the US and other jurisdictions, the attractiveness of offering banking services in regions with relatively low-volume and value of transactions, like the Caribbean, is likely to continue to wane. In addition, the increased costs of regulation and compliance are forecast to be a permanent feature of the international banking landscape notwithstanding expectations that the 2010 Dodd-Frank that reshaped US banking might be rolled back under the current US administration. Moreover, global banking industry analysts see the era of ever changing regulations as “here to stay”.<sup>31</sup>

<sup>28</sup> Prime Minister Browne of Antigua and Barbuda and Prime Minister Barrow of Belize.

<sup>29</sup> IMF (March 16, 2017), p. 27.

<sup>30</sup> The Commonwealth Secretariat (2016).

<sup>31</sup> Grasshoff, et.al. (2017), page 4.

### **III. De-risking experience and impacts: case study of Belize**

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This section of the report highlights the main findings of the case study on de-risking in Belize.<sup>32</sup> First, an overview of the financial sector is presented followed by the country's experience to date with de-risking and the drivers of de-risking as identified by stakeholders. An outline of the financial regulatory institutional framework in Belize is then presented followed by stakeholder feedback on the impacts.

#### **A. Background on the financial sector: structure and performance status**

Belize is the most open of the three study countries with a financial system that is large relative to economic activity. Concomitant with increased openness and global linkages to Belize's real economy, financial leverage and participation and integration have also grown and deepened<sup>33</sup> overtime. As of June 2017, the financial system was comprised of total of 32 institutions with assets of US\$2.8 billion (166 per cent of GDP) in 2016 up from US\$464 million (72 per cent of GDP) in 2014. At the end of 2016 there were five commercial (domestic) banks<sup>34</sup> (Table 1), with total assets of US\$1.6 billion. These are focused on the domestic economy lending in Belize dollars to residents (nationals and foreigners). Four of the five domestic banks are local banks; one commercial bank is the branch of a Canadian global bank.<sup>35</sup> There are five international banks<sup>36</sup> (offshore banks) with total assets of US\$530.6 million in

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<sup>32</sup> Please refer to the full report should a more comprehensive examination be of interest.

<sup>33</sup> The ratio of broad money to GDP, a proxy for financial sector development, relatively high and has increased overtime to 84 per cent in 2016 as compared to 77 per cent in 2012. This compares with a ratio of 65.5 per cent for LAC and 42.75 for least developed countries (UN categorization).

<sup>34</sup> Commercial banks that provide financial services onshore in Belize are referred to as domestic banks. As of end-2016 there were six domestic banks. However, CIBC First Caribbean International Bank sold its local branch to Heritage Bank Ltd. in January 2016.

<sup>35</sup> The share of local ownership in the local banks represented 31.3 per cent in 2016.

<sup>36</sup> The term "international banks" in Belize are offshore banks, that is, banks that collect deposits and other liabilities from non-residents and provide loans mainly to non-residents, including those who invest in Belize, and domestic businesses in the Export Processing Zones and Commercial Free Zones. Both domestic and international banks are regulated and supervised by the Central Bank of Belize.

2016 offering loans to foreign investors in Belize and also financial services to international banking corporations and the offshore sector.

In Belize, domestic banks have been the main financial intermediary for the onshore economy with about 90 per cent of loans being extended to domestic entities. Credit unions, with assets of US\$368 million in 2016, have been a reliable source of financing for households and micro and small businesses. In the case of International (offshore) banks which emerged after activation of facilitating legislation in 2003 their assets had peaked at US\$787 million<sup>37</sup> in 2014 (46 per cent of GDP). Loans represented 48.4 per cent of their total assets.

**Table 1**  
**Financial institutions operating in Belize**  
(Assets in Belize dollars, millions)

	1996		2012		2016	
	Number of institutions	Total assets	Number of institutions	Total assets	Number of institutions	Total assets
Domestic banks	4	707	5	2 760	5	3 228
Credit unions	11	106	12	651	12	903
International banks	-		6	1308	5	1061
Nonbank financials	1	63	2	97	1	105
Insurance companies	15	53	12	216	9	272

Source: Central Bank of Belize.

## B. Loss of correspondent banking services: the Belize experience

The withdrawal of correspondent banking services (CBS) from Belize began in the *onshore domestic banking sector*. The largest domestic bank that traditionally lends mainly to the productive sectors (Bank B, table 2) was hit by the withdrawal of its two correspondent banks providing full banking services in April 2015. By October 2015, Bank D<sup>38</sup> also lost its one US correspondent bank providing full banking services followed by Bank A in December 2015. Bank B subsequently secured interim correspondent banking services via an international MTSP<sup>39</sup> and smaller banks in Turkey and Puerto Rico offering wire transfer services.

The other two banks had a German correspondent bank providing full banking services as well as other correspondents and international money transfer operators providing wire transfer services. However, by April 2016, the German correspondent bank completely withdrew from Belize as a jurisdiction. By mid-2016, Belize's domestic and international banks were prospecting for new CBRs. The Central Bank of Belize stepped in to provide US dollar wire transfer and check clearing services until it discontinued this service in September 2016 at the request of its correspondent bank. Three domestic banks lost 90 per cent of their established CBRs during a twelve-month period in 2015 and 2016.

<sup>37</sup> This amount is below the large estimate of assets (and liabilities) reported by the BIS area banks vis-à-vis counterparties resident in Belize. According to BIS Locational Banking Statistics, total claims of Belizean counterparties vis-à-vis BIS banks were about US\$ 14.7 billion at end-2015.

<sup>38</sup> Bank C was purchased by bank D in 2015.

<sup>39</sup> Two of the affected banks used WorldClear a multi-currency clearing operator that sends and receives bank-to-bank payments.

**Table 2**  
**Domestic bank assets 2012-2016**  
*(Belize dollars, millions)*

	Bank A	Bank B	Bank C	Bank D	Bank E	Bank F	Total
2012	562.8	928.7	283.8	243.8	---	740.7	2759.8
2013	637.9	919.0	299.8	204.5	9.5	759.2	2829.9
2014	712.3	964.0	292.0	226.4	24.8	777.8	2997.2
2015	843.8	970.9	338.8	251.3	47.2	797.0	3249.0
2016	901.2	922.7	----	490.5	47.3	865.9	3227.6

Source: Central Bank of Belize.

The withdrawal of correspondent banking services in Belize in early 2015 with the de-risking of a major domestic bank occurred at the time of material documented progress with respect to the prudential improvements and strengthening of AML-CFT frameworks in Belize. In late 2016, the IMF highlighted considerable progress on the AML-CFT regulatory front in Belize<sup>40</sup>. Notwithstanding, these assessments from the IMF and CFATF, the misperception of Belize as a high risk because of deficiencies in its AML-CFT regime continued in the public domain with misreporting and mischaracterizations of the jurisdiction including by reputable financial magazines<sup>41</sup>.

Against the backdrop of the withdrawal of CBS from Belize notwithstanding the positive assessment from CFATF, the IMF had two main recommendations for allaying fears of additional withdrawal of CBS. First, it recommended improved transparency in the offshore sector to help further improve compliance with international standards and understanding of money laundering and terrorist financing risks. The IMF assessed that Belize’s “substantial offshore financial sector<sup>42</sup>” generates relatively low fiscal revenues and offers services that are highly vulnerable to money laundering and terrorism financing.<sup>43</sup> Secondly, it recommended stronger implementation of the AML/CFT framework as a defensive strategy to address de-risking. It is noteworthy also that notwithstanding Belize’s recognized progress on the AML-CFT front that official US Government websites continue to reference incorrectly the 2013 CFATF sanction of Belize that was lifted notwithstanding the positive 2014 CFATF assessment<sup>44</sup>.

### C. Drivers of de-risking in Belize: response of stakeholders

During consultations, stakeholders in Belize identified the following as the main country specific drivers of de-risking:

- The low profitability for correspondent banks in providing CBSs to Belize and the perception of the country as a relatively high-risk jurisdiction;
- Illicit activities associated with Belize’s international banks<sup>45</sup> including the alleged sheltering of US tax evaders;
- The operations of export free zones in the jurisdiction as facilitating money laundering; and

<sup>40</sup> IMF (October 2016).

<sup>41</sup> See *The Economist Financial derisking Forget whiter than white*” and *Financial derisking The great unbanking*, (Volume 424, No. 9048, July 8-14, 2017). These unsubstantiated claims were challenged by the CBB.

<sup>42</sup> IMF, Selected Issues, (June 2016), p. 51.

<sup>43</sup> Note that the contribution of Belize’s offshore sector in terms of employment and to GDP has not yet been estimated.

<sup>44</sup> See <https://www.state.gov/j/inl/rls/nrcrpt/2014/vol2/222688.htm>, outdated US State Department website.

<sup>45</sup> The term “international banks” in Belize are offshore banks, that is banks that collect deposits and other liabilities from non-residents and provide loans mainly to non-residents, including those who invest in Belize, and domestic businesses in the Export Processing Zones and Commercial Free Zones. Both domestic and international banks are regulated and supervised by the Central Bank of Belize.

- The perceived slow response by Government, regulatory agencies and banks to US FATC and AML-CFT-related requirements.

Most stakeholders appear unaware of the progress in the banking sector in redressing prudential weaknesses and also in updating and strengthening AML-CFT frameworks. There was also limited awareness of the strengthened regulatory framework of Belize’s financial sector by the Central Bank—not only of banks, but also of credit unions and other non-bank financial institutions. Most stakeholders were also not aware that there are now legitimate businesses operating in the export zones and that these businesses were regulated<sup>46</sup>. **Clearly this lack of knowledge on the part of stakeholders on the improvements being made by the country with respect to compliance with international regulatory standards suggests absence or weaknesses in information dissemination.**

## D. Belize financial regulatory frameworks and initiatives to address weakness

The responsibility for regulation of domestic banks, international banks, credit unions, money transfer operators and other types of financial institutions in Belize is the Central Bank.<sup>47</sup> Over recent years there have been a number of initiatives aimed at strengthening the regulatory and supervisory framework of the financial sector including the following:

- **The Financial Sector Assessment Program (FSAP):** The FSAP, developed in 2013, identified weaknesses and challenges in several areas of the financial sector and recommended actions for a reform agenda including revision of the *Domestic Banking and Financial Institutions Act (BFIA)* (January 2013), amendment of the Credit Union Act (2013) and in 2016 introduced measures to strengthen regulation with respect to money lenders, pension funds and insurance companies.
- Reflecting on Belize’s ongoing commitment to reforms that strengthen the soundness of financial sector, the IMF has assessed in the context of Article IV consultations with Belize that since 2013 significant progress has been made in implementing the key FSAP recommendations for the banking system.
- **AML-CFT Initiatives:** Belize’s *Financial Intelligence Unit*, established in 2002, is responsible for AML-CFT initiatives including monitoring, reporting and prosecution. Unable initially to fulfill its responsibilities on account of resource and technical constraints by May 2014 CFATF assessed that Belize had addressed its AML/CFT deficiencies. More recently, to bring Belize’s legal framework into further alignment with the FATF recommendations, the *Money Laundering and Terrorism (Prevention) Act, 2008* was amended in February 2016.

## E. Impact of de-risking in the Belize’s banking sector: indicators, survey data and consultation feedback

**Overview of Impact on the Banking Sector:** The withdrawal of correspondent banking services adversely affected banks in Belize more severely than in the other study countries. Regarding the survey of banks, four of the five domestic banks participated in the survey<sup>48</sup>. Of these 3 banks (75 per cent) indicated that they were significantly adversely affected by the withdrawal of correspondent banking services.

At the height of the withdrawal of CBS in Belize the share of the assets of the domestic banks affected by the withdrawal of CBS was 72 per cent. The share of total assets of international banks affected by de-risking was 93 per cent.

<sup>46</sup> The EFZs are regulated by Belize’s Financial Intelligence Unit and the Central Bank of Belize.

<sup>47</sup> Currently there are no licensed financial institutions in this category.

<sup>48</sup> One of the domestic banks completed the questionnaire for the business sector and the results are compiled with the responses for the banking sector survey where possible.

**Specific impacts on the banking sector:** The following were the main feedback from the survey/consultation of the banking sector on the impact of de-risking:

- **Cost increases and US dollar transactions:** Most businesses in the context of the consultations indicated cost pressures and difficulties executing US dollar transactions.
- **Doubling of transaction and operating costs:** Eight of 10 banks indicated a doubling of their transaction and operating costs with most noting that these costs were increasingly being passed on to bank customers, with a lag, through higher fees.
- **Decline in the value of wire transfers:** The largest domestic bank indicated a decrease in the value of wire transfer services of 9 per cent in 2015 and 20 per cent in 2016. One of the other two affected banks indicated a loss in the value of wire transfer services of 9 per cent in 2016.
- **Income losses:** The largest commercial bank indicated income losses associated with the inability to execute transactions for exporters, importers, and money transfer operators of about US \$1.6 million in 2015.
- **Cost related to strengthening AML-CFT:** Bank stakeholders also referenced material increased cost related to strengthening existing AML-CFT frameworks. Cost estimates of for strengthen AML-CFT compliance since mid-2015, ranged from US\$0.5 million to US\$2 million. One of the two largest domestic banks indicated a cost of US\$60,000 per year for external AML-CFT audits. Three of the five domestic banks indicated AML-CFT related ongoing annual training costs of staff in the range of US\$100,000 to \$200,000 per year. One domestic bank indicated that it had hired 4 additional staff responsible for AML-CFT amounting to increased payroll costs of US\$110,000 per annum.
- **Inability to provide US dollar check clearing:** Both the Central Bank of Belize and commercial banks indicated that all commercial banks except one were no longer able to provide US dollar check clearing services for customers given that correspondent banks were unwilling to provide this service. This development which began in advance of the de-risking crisis has forced the use of wire transfers and credit cards at a higher cost for banks and their customers. For the one bank that can provide clearing of US dollar checks. This service is not automatic and takes considerable time<sup>49</sup>.
- **Shift in deposits and in the distribution of banking sector lending<sup>50</sup>:** The withdrawal of CBS from domestic banks led to a shift in deposits away from these banks, lending predominantly to the productive sectors, to those engaged mainly in retail lending, with negative implications for GDP growth and the generation of foreign exchange.
- **Decline in assets of international banks:** As a consequence of de-risking the assets of the international banking sector operating in Belize declined by US\$256 million from end-2014 to end 2016. In the case of the two largest international banks assets declined by 21 per cent for the same period.
- **Reduced transparency and longer processing times for transactions:** The intermediaries that stepped up in the aftermath of de-risking of domestic banks to provide wire transfer services included international money clearing houses and banks smaller and with less capital cushions than the banks that were de-risked. The de-risked banks and their clients have had funds tied up for several months.

Generally, senior managers of the respondent domestic and international banks expressed frustration at the double standard with respect to AML-CFT and FATF requirements facing banks in

<sup>49</sup> The bank that is clearing US dollar checks, sends the checks by courier and it takes over one month to clear these checks.

<sup>50</sup> In Belize the relative importance of domestic banks changed also with respect to foreign exchange holdings as de-risked banks providing services to the export sectors lost these customers.



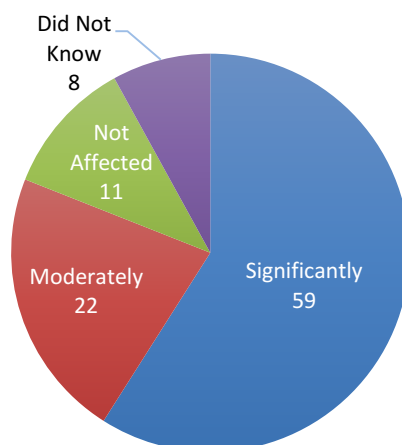
Belize as compared to relatively lax requirements facing banks in the U.S.<sup>51</sup>. In this regard, the duplicity of correspondent banks is revealed by the fact that while correspondent banks were terminating key service such as wire transfers and check clearing services, they continued to provide US dollar cash courier services considered the most susceptible to AML-CFT risks. Notwithstanding these events, there was consensus among banking sector officials that the situation with respect to CBRs was “stable but fragile”.

## F. Independent impacts of de-risking on the productive and non-bank financial sectors: findings of the survey/consultations

The withdrawal of correspondent banking services (CBS) from Belize has also had adverse impacts on the broader economy as well as on businesses and non-bank financial institutions. As concerns the broader economic outlook and Belize’s ability to borrow in commercial markets and attract foreign investment, the de-risking of three of five domestic banks led to a cut in Belize’s sovereign credit rating in 2016<sup>52</sup>. Regarding the impact on businesses, as discussed above, banks facing increasing costs of compliance and for processing international transactions passed these increased costs of doing business onto their customers through higher fees for both Belize dollar and US dollar denominated transactions. In this regard, the higher costs of CBS represented a significant negative supply shock for most businesses.

Consistent with the above assessment, the general finding of the non-bank survey is that 81 per cent of respondents indicated that they were negatively affected by the withdrawal of CBS. In the case of businesses operating in the tourism sector (50 per cent of the sample), two-thirds of businesses indicated that they were significantly adversely affected by de-risking.

**Figure 4**  
Belize impact of de-risking reported by non-bank respondents  
(Per cent)



Source: ECLAC survey on the Economic impact of de-risking for non-banks in Belize.

Based on feedback of respondents as well as consultations the following were the main impacts noted:

<sup>51</sup> For example, most respondents noted that any Belizean can with limited documentation open an account in Florida with a US bank.  
<sup>52</sup> On November 15, 2016, Standard and Poor’s (S&P) downgraded Belize’s sovereign rating from “B-” to “CCC+” with a negative outlook citing the loss of correspondent banks and noting that finding replacements was “very complicated”. as well as Belize’s large debt burden. S & P also emphasized the deterioration in Belize’s ability to service its external debt. In March 2017, Belize’s rating was returned by the rating agency to “B-“. Moody’s maintained Belize’s sovereign rating at Caa2 (Stable) from 2015 to April 2017 when it was increased to B3.

- **Impact on Tourism Operators:** The Belize Chamber of Commerce (BCCI) as well as the umbrella organizations for Belize’s tourism sector<sup>53</sup> indicated reports from their members of material increases in the cost of doing business resulting from the withdrawal of CBS. Specific impacts include:
  - An increase in the monthly service charge fee by 4 per cent by the largest domestic bank that had provided services to the majority of tourism sector operators. Additionally, there were new charges that increased monthly costs in the range of 12 to 20-fold<sup>54</sup>.
  - More costly means for transferring US funds—via wire transfers<sup>55</sup>—into Belize dollar accounts on account of the loss of US dollar check clearing services.
  - In 2016 many businesses in the tourism sector resorted to the use of their credit card settlement accounts for funding albeit at a materially higher cost<sup>56</sup>.
- **Cruise ship tourism sector:** Stakeholders indicated that operators had gone for 3.5 months without being able to receive and repatriate payments from the cruise ship companies for services provided.
- **Availability of Foreign Exchange:** A major concern of most tourism sector stakeholders was the availability of foreign exchange in the system on an ongoing basis. In this regard, many stakeholders were no longer repatriating US dollar revenues. Instead they were leaving US dollar balances offshore to meet business related foreign exchange requirements. Others were hedging the uncertainty of the availability of foreign exchange in the future.
- **The Export Zones:** Businesses operating in Belize’s export zones and export processing zones<sup>57</sup> reported debilitating effects from the loss of CBS. Specific impacts were:
  - The casinos<sup>58</sup> and other businesses operating in the zones in Corozal<sup>59</sup> and Benque Viejo indicated the unwillingness of domestic banks in Belize to provide international banking services.
  - The need for these businesses to hold large cash balances on account of the inability to transact business in US dollars. This was reported to be causing material disruptions in business operations.
  - Stakeholders also lamented a breakdown in long-term relationships with suppliers arising from disruptions in banking services including the loss suppliers’ discounts and relaxed payment arrangements previously accorded.
  - As a consequence of de-banking, businesses in the zones resorted to conducting transactions in cash, using the parallel foreign exchange market and contracting intermediaries including companies in Mexico and Guatemala to make payments and receive funds albeit at a high cost<sup>60</sup>. In this regard, stakeholders estimated the size of the

<sup>53</sup> There are three umbrella organizations serving business stakeholders in Belize’s tourism sector, the Belize Tourism Industry Association and the Belize Hotel Association (BTIA), the Belize Hotel Association (BHA), and the Belize Association of Cruise Service Providers.

<sup>54</sup> The bank introduced a service charge per transaction of about Bze\$1.50.

<sup>55</sup> The one domestic bank with a stable CBR charged the flat fee plus 4 per cent of the value of the transaction.

<sup>56</sup> Two Belize banks lost their credit card settlement accounts in the USA. These banks were unable to settle their credit card balances with payment systems operators. These closures have had significant implications for the tourism industry in Belize as well as other international businesses operating from the country.

<sup>57</sup> Belize has export processing zones (EPZs) set up under the EPZ Act 2000 (revised). Belize also has Free Zones (FZs) under the Free Zones Act 2005. Entities set up and operating in these zones are by law exempt from taxes and duties as well as from the foreign exchange regulations.

<sup>58</sup> The casinos in the Corozal export zone were among the first casualties of de-risking.

<sup>59</sup> The Commercial Free Zone Act of 1994 has established a Commercial Free Zone (CFZ) at Corozal to attract foreign investment.

<sup>60</sup> For example, Mexican companies will execute wire transfers for businesses in the Corozal Zone at a cost of 7-10 per cent of the value of the transaction.

parallel market in which they participated to be about BZ \$700 million/US\$350 million (20 per cent of 2016 GDP).

- **Impact on the MTSP:** The impact of de-banking on the operations of MTSP in Belize reduced the access of MTSP clients—the poor and migrant workers—to the formal financial system with negative implications for financial inclusion.
- **Impact on Credit Unions:** While credit unions were not de-risked they face material increases in operating costs. Domestic banks continued to provide services to credit unions for their own account but discontinued the provision of services for credit union members.
- **Leakages of Foreign Exchange into the Parallel Market:** The CBB<sup>61</sup> indicated that as a consequence of de-risking there was an excess demand for foreign exchange in the formal market given the leakages into the parallel market.
- **Other Costs:**
  - Delays in executing transactions
  - Increased documentation requirements for transactions with lower value thresholds triggering these requirements.
  - Increased costs arising from opening/maintaining accounts with all domestic banks to assure accessibility to correspondent banking services.

## G. Main conclusions and outlook

De-risking began in Belize in April 2015 and was dismissed initially to be the problem of one domestic bank. De-risking became systemic with seven out of ten banks losing CBRs triggering widespread disruptions in Belize’s broader economy and foreign exchange and trade markets. After a tumultuous 12-month period, with limited CBS, a UK bank entered the jurisdiction of Belize providing CBS through its US correspondent bank. The costs of more limited CBS to Belize represented a significant supply shock to banks. The outlook for Belize’s banking sector is characterized as “stable but fragile.” This assessment notwithstanding, one international bank received notice in August 2017 from its sole correspondent bank that the relationship would be discontinued end-September 2017 generating uncertainty.

As survey data and consultation discussions reveal, Belize’s business sectors have been adversely affected by the withdrawal of CRBs to different degrees. The businesses most materially affected are those that have been de-banked—those in the Export Zones along with MTSP. Businesses in the tourism sector, Belize’s fastest growing sector, have also been adversely affected by higher costs and the loss of the use of US dollar checks. These costs include longer processing times for transactions at more than double the prices for those services. This erosion of the competitiveness of the tourism sector comes on the back of an appreciating real effective exchange rate. Most (73 per cent) of the businesses operating in Belize that participated in the survey indicated that if de-risking were to continue this would result in lower investment and expenditure in their businesses translating into lower business growth.

Turning to potential impact of a continued withdrawal of CBR and CBS on Belize’s broad economy, the outlook for GDP growth over the medium-term is forecast as under 2 per cent (with unchanged policies, not taking into account any negative impact from the withdrawal of CBS). This forecast for GDP could be further weakened by foreseeable unfavorable developments including additional loss of CBRs. The links that would facilitate lower GDP would be lower annual exports and private capital inflows (including FDI and remittances) and negative hits on banks’ balance sheets including through lower income and higher transactions costs<sup>62</sup>. Specifically the estimated output loss in

<sup>61</sup> CBB, Financial Stability Report 2015-2016 (September 2016), pp. 1 and 17.

<sup>62</sup> Note that because of ongoing provisioning aimed at reducing NPLs as a percent of total loans and assets, the profitability of banks in Belize has been depressed.

terms of GDP ranges from about 1 to 4.5 percentage points of GDP on average under a low CBR-stress as compared to a high CBR-stress scenario from 2017 to 2021<sup>63</sup>. This compares with an output loss for Belize in 2016 associated with Hurricane Earl of 4 percentage points of GDP.

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<sup>63</sup> IMF (October 2016).



## **IV. De-risking experience and impacts: case study of Saint Kitts and Nevis**

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The section of the report highlights the main findings of the case study of de-risking on Saint Kitts and Nevis<sup>64</sup>. The presentation is structured similarly to that outlined in Section III on Belize.

### **A. Withdrawal of correspondent banking services in Saint Kitts and Nevis – the experience**

The withdrawal of CBS in the Federation of Saint Kitts and Nevis (SKN) commenced in May 2016 when one of the country's major domestic banks received notification from its US correspondent bank that services would be terminated in November 2016<sup>65</sup>. The US correspondent bank also terminated US dollar check clearing services. The domestic bank encouraged customers to use wire transfer services in lieu of US dollar checks albeit at a higher cost. It was also able to secure interim US dollar services through one of its European correspondent banks at a higher cost and with longer times to execute transactions. Subsequently, in November 2016, one of the bank's European correspondent banks indicated that it would terminate its CBS in February 2017.

The second domestic bank to receive notification of the withdrawal of CBS was the country's largest indigenous bank. Notification came from its US correspondent bank, the same US correspondent bank referenced above. However, in this case the domestic bank was able to successfully negotiate a reprieve from its US correspondent bank.

Additionally, the Federation's sole international bank operating in the offshore financial sector lost 2 of its 3 CBRs between January and February 2017. Its US correspondent bank indicated that the action was a business decision based on profitability and was unrelated to AML-CFT compliance.

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<sup>64</sup> Please refer to the full report should a more comprehensive examination be of interest.

<sup>65</sup> The bank received an extension and the US correspondent bank terminated the relationship in January 2017.

It should be noted that the notices of withdrawal of corresponding banking services to the two domestic banks triggered defensive response actions by other commercial banks in SKN. Under pressure to retain the services provided by their correspondent banks these other banks began de-banking all trusts and insurance companies. In the case of the foreign commercial banks they had begun de-banking investors on-boarded under the rubric of the CBI program in 2014. Thereafter, indigenous banks began on-boarding these de-banked customers.

## B. The financial sector in Saint Kitts and Nevis<sup>66</sup>

The financial sector of the Federation is relatively deep<sup>67</sup> and dominated by commercial banks—national banks and branches of foreign banks (foreign banks). There is also one offshore bank regulated by the Financial Services Regulatory Commission (FSRC)—Nevis branch. Currently half of the 6 commercial banks operating in Saint Kitts and Nevis are national banks and half are foreign banks.

The Federation is the most leveraged of the financial sectors in the ECCU with the assets of banks and credit unions estimated at more than 3 times the size of the economy at end-December 2016.<sup>68</sup> In this regard, financial leverage increased after 2012 when the investments required in the context of the **Citizenship by Investment (CBI)** programs were increased materially<sup>69</sup>. Total banking sector assets grew rapidly on average between 2012 and 2016 representing rapid average increases in the assets of national commercial banks (see table 3). The share of the ECCU assets held by the Federation’s banks increased to 25.3 per cent in June 2017 as compared to 13.8 per cent on average between 2012 and 2016.

**The Offshore Financial Sector:** The offshore financial sector in the Federation, operating out of Nevis, was developed as a deliberate strategy to diversify the economy. The legislation governing the licensing of financial sector service providers was modeled on that of advanced economies—the US and New Zealand. The offshore sector is comprised of an offshore bank (1), registered agents—trust and corporate service providers (55), insurance managers (18), insurance brokers (5) and international insurance companies (340). Like most of the offshore banks incorporated in the various jurisdictions in the ECCU this bank is the subsidiary of an indigenous bank.

The offshore sector has made gains in its contributions to the economy in terms of employment and revenue generation especially with respect to the economy of the island of Nevis. Revenue generation from Nevis’ financial services sector has increased over time amounting to EC\$14.2 million in 2016 (or 1.9 per cent of total revenue)<sup>70</sup> up from an average of EC\$ 12.8 million in 2012-2015. Estimates by industry experts place the total contribution of the sector in the range of 10-18 per cent of GDP and employment at more than 1000 employees.<sup>71</sup> As in other jurisdictions in the Caribbean, the offshore sector in Saint Kitts and Nevis has been under considerable pressure in recent years, characterized as tax havens for US tax evaders as well as vulnerable to ML-FT.

**Table 3**  
**Saint Kitts and Nevis: total commercial banking sector assets**  
(EC dollars, millions)

	2012	2013	2014	2015	2016	June 2017
National Banks (NB)	2 900.7	3 392.6	3 879.7	4 025.5	4 140.6	4 136.7
Foreign Banks (FB)	2 596.2	2 612.6	2 827.8	2 974.9	2 930.9	3 264.8
Total	5 496.9	6 005.1	6 707.5	7 000.3	7 071.4	7 401.6

<sup>66</sup> Data are only available on Saint Kitts and Nevis’ banking sector.

<sup>67</sup> The ratio of broad money to GDP is high at 128 per cent in 2015 and 117 per cent in 2016 in the range of the average ratio for high income countries in 2016—119 per cent.

<sup>68</sup> Loans extended by credit unions as of March 31, 2017 are estimated as EC\$218.5 million.

<sup>69</sup> In January 2012, the government of Saint Kitts increased the minimum investment amount in the Sugar Industry Diversification Fund to USD \$250,000 and to US\$400,000 as a real estate investment.

<sup>70</sup> Total current revenue was EC\$766.3 in 2016.

<sup>71</sup> These are the estimates provided during the consultation discussions.

Table 3 concluded

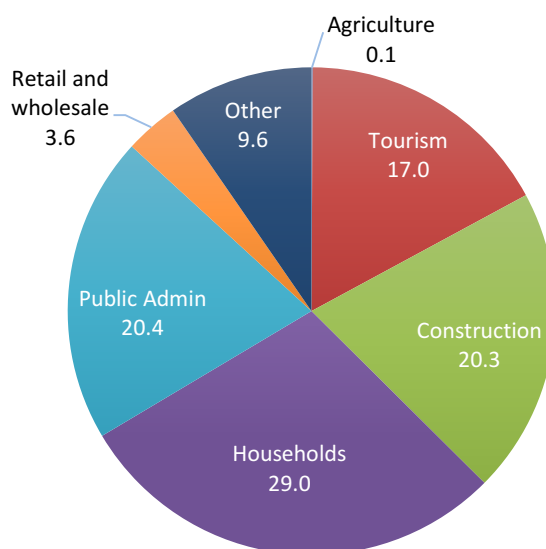
	2012	2013	2014	2015	2016	June 2017
Memo Item:						
Average ROA	0.6	0.7	0.6	0.8	0.9	0.3
National banks share of total assets	52.8 per cent	56.5 per cent	57.8 per cent	57.5 per cent	58.6 per cent	55.9 per cent

Source: Eastern Caribbean Central Bank.

## 1. Health of the financial sector

The domestic banking system is broadly stable after years of challenges. Risk-adjusted capital adequacy has improved and NPLs have been reduced. The Federation is in the process of establishing deadlines for full implementation of Basle II the current international benchmark for bank supervision.<sup>72</sup> Nevertheless, the banking sector remains subject to significant challenges of high liquidity, low lending mainly to households (Figure 5) and increased concentration of lending by foreign banks. The largest risks to the banking sector concern the resolution of land for debt swaps,<sup>73</sup> weak asset quality and the risk of the additional withdrawal of CBS.

**Figure 5**  
Saint Kitts and Nevis national banks sectoral distribution of loans, 2016  
(Per cent)



Source: Eastern Caribbean Central Bank.

## C. Drivers of de-risking in Saint Kitts and Nevis

Based on consultations, stakeholders identified the following as the main drivers of de-risking:

- **Low profitability** associated with corresponding banking services and the perception of the Federation as a relatively high-risk jurisdiction.

<sup>72</sup> See <http://www.nevisfsrc.com/publications/consultation-papers>.

<sup>73</sup> The land-debt swap reduced both the government's debt as well as the financial system's exposure to the government. However, it meant that banks continued to hold a relatively illiquid asset (land).



- **Citizen by Investment Program (CBI):** Was seen as an important driver of de-risking given questions of adequate disclosure and beneficial transparency of the program. Stakeholders were of the view that it led correspondent banks to re-evaluate providing services in the jurisdiction given the increased scrutiny by US and Canadian regulators of these programs.
- **The mischaracterization of the offshore financial sector** in Nevis as a “tax haven” with all of the attendant negative connotations (although a legitimate profitable, competitive and thriving financial services provider).
- **Misconceptions and misreporting on the state of the AML-CFT regulatory framework** in the Federation used as a cloak by correspondent banks to de-market the jurisdiction because of low profits in the jurisdiction and rising interest rates in the US.
- **The influence of regulators in competing OFCs:** Many private stakeholders were also of the view that the success of the country’s offshore financial sector may have triggered retaliatory responses from regulators in competing OFCs in advanced economies. In this regard, the characterization of the OFCs in Saint Kitts and Nevis and other Caribbean islands as “tax havens” represented an attempt to brand the jurisdiction as vulnerable to ML-FT.

## D. The financial regulatory framework and actions aimed at meeting global standards

### 1. The financial regulatory framework in the Federation

As a member of the Eastern Caribbean Currency Union (ECCU) the regulatory framework for SKN’s financial sector includes regulations provided both under the rubric of the Eastern Caribbean Currency Union (ECCU) and those provided by the National regulatory institutions. Respective responsibilities under each are discussed below.

**Role of the ECCU in Financial Regulations:** Under the ECCU arrangement, the Eastern Caribbean Central Bank (ECCB) serves as a mechanism for financial and economic cooperation.<sup>74</sup> The ECCB also serves as the main prudential regulator of both domestic (“national”) banks and foreign owned banks (excluding offshore banks).

Oversight of the financial sector is shared between the ECCB and the national authorities.<sup>75</sup> Domestic banks (domestic and foreign banks) are regulated and supervised under the *ECCB Agreement Act, 1983* under which the ECCB is the supervisor for all private (domestic and foreign) and state-owned banks. Under the *Uniform Banking Act* of SKN key regulatory and supervisory decisions, including the licensing and enforcement, are taken by the relevant Ministers of Finance on recommendation from or after consultation with the ECCB. The ECCB is also responsible for the supervision of nonbank financial intermediaries licensed under the Banking Act.

Insurance intermediaries and nonbank depository institutions (cooperative credit unions, building societies and development banks) are under the jurisdiction of national supervisory authorities, mainly within the Ministries of Finance. National supervisory agencies (NSAs) have been established in seven of the eight ECCU territories. These are largely responsible for the supervision of offshore banks, trust companies and other offshore services providers (including in some cases internet gaming) in accordance with national laws.

<sup>74</sup> Eastern Caribbean countries institutionalized political and economic cooperation through the establishment of the Organization of Eastern Caribbean States (OECS) with the Treaty of Basseterre in 1981. Two years later they set up the Eastern Caribbean Central Bank (ECCB), which replaced the Eastern Caribbean Currency Authority.

<sup>75</sup> The ECCB is itself governed by a Monetary Council comprising the Ministers of Finance from each of the participating Governments.

## 2. Actions aimed at meeting global financial regulations

- **AML-CFT Regulatory Framework:** The Federation has established a robust AML/CFT legal and regulatory framework in accordance with the FATF Recommendations. According to the CFATF, since 2009 Saint Kitts and Nevis has had measures in place to mitigate ML-FT risks and threats to the financial services industry in Nevis<sup>76</sup>.
- **The Financial Services Regulatory Commission (FSRC)**<sup>77</sup> is the regulatory body which licenses, supervises and regulates the operations of the financial services sector in Saint Kitts and Nevis. In this regard since February 2014, regulated entities have been subject to comprehensive off-site and on-site inspections consistent with the Saint Kitts and Nevis' Risk-based Supervisory Framework<sup>78</sup>.
- **The Financial Intelligence Unit-Saint Kitts and Nevis (FIU-SKN):** This Unit focuses on assuring compliance of designated non-financial institutions with AMF-CFT regulations. The regulatory authorities have increased efforts in AML/CFT monitoring including continued comprehensive on-site examinations of all categories of financial service providers<sup>79</sup> as well as mechanisms to ensure entity transparency in line with evolving relevant international standards.
- **On-going due diligence & legislation update:** Financial institutions and regulators are engaged in a perpetual process of enhancing due diligence and amending legislation in response to ever evolving requirements of different international regulatory and standard setting bodies including the Basle Committee, FATF, CFATF and the OECD.
- **Tax transparency:** St Kitts and Nevis has met the OECD/ G-20<sup>80</sup> “objective criteria” with respect to international tax transparency.
- **Compliance with FACTA reporting:** Saint Kitts and Nevis is also the only Competent Authority within the ECCU that submitted 2014 filings to the IRS under FATCA.

It was clear during the discussions with stakeholders that they were generally unaware of the country's progress in strengthening AML-CFT frameworks and of the proactive role of regulators in responding to the ever changing regulatory rules of international regulatory standard setters. Stakeholders were also unaware of changes to the CBI programs requiring information on beneficial ownership of legal persons and legal arrangements in line with evolving relevant international standards.

## E. Impact of de-risking on the Federation's banking sector: consultation feedback<sup>81</sup>

Based on feedback of banking stakeholders the following were the main impacts identified:

- **Response of correspondent and respondent banks to the CBI Program:** While all banks had facilitated investor flows when the CIB program was initiated, branches of the foreign banks were unable to continue “to bank” these foreign investors due to issues concerning the backgrounds of the foreign investors. Also, correspondent banks providing services tightened disclosure requirements and materially increased fees for providing international banking services to domestic banks.

<sup>76</sup> CFATF, Ninth Follow up Report, Saint Kitts and Nevis, December 2, 2014.

<sup>77</sup> The FSRC is comprised of a branch which regulates Saint Kitts (FRSC-Saint Kitts) and a branch which regulates Nevis (FRSC-Nevis).

<sup>78</sup> The framework was adopted by the FSRC in 2015 and approved by the FSRC Board of Commissioners in June 2017.

<sup>79</sup> During July 2013-June 2016, the FSRC—Nevis Branch conducted 45 AML-CFT on site examinations on regulated entities.

<sup>80</sup> See Communique of G20 Finance Ministers and Central Bank Governors paragraphs, 9-13, <http://www.pbc.gov.cn/english/130721/3106268/index.html>.

<sup>81</sup> No banks licensed in the jurisdiction of the Federation participated in the survey of the banking sector. However, 4 of 7 banks participated in the consultation discussions.

- **Blacklisting of the offshore financial sectors:** Federation authorities and banking officials were of the view that the offshore financial sectors in the Caribbean including in Nevis were under assault. There were insinuations of non-compliance with AML-CFT regulations and the attendant risks of money laundering and hints that the Federation’s offshore sector lacks tax transparency and shelters US tax evaders. As a result, there was a general blacklisting of the offshore financial sectors notwithstanding updated and now relatively strong legislation and regulatory frameworks in the OECs states. A myriad of misreporting in US official reports and by the news media on the state of the regulatory framework for supervising the offshore financial sector painted a negative profile of the offshore sectors.
- **De-marketing of financial institutions in Nevis:** Despite good progress on the AML-CFT front, financial sector institutions in Nevis faced de-marketing rather than de-risking.

## F. Impact of de-risking on the non-bank financial and productive sectors: survey results and consultation feedback

The survey results for Saint Kitts and Nevis for the non-bank financial and productive sectors indicated that more than half of survey respondents<sup>82</sup> experienced significant to moderate adverse impact from the withdrawal of CBS (see figure 6) with more than two-thirds of stakeholders reporting significant negative effects.

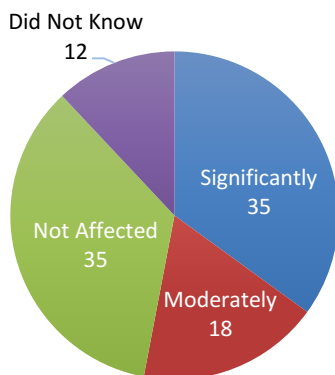
The main impacts of the withdrawal of corresponding banking services identified by non- bank stakeholders were as follows:

- **Increased cost of international financial transactions:** Identified by the largest number of private sector stakeholders respondents as an impact of de-risking
- **Disclosure requirements:** Respondents also indicated that banks were requiring greater disclosure as well as more time for executing international transactions
- **Services most affected:** In terms of the services most adversely affected respondents identified money transfer service providers as well as businesses providing financial services offshore –mainly trusts and insurance companies.
- **Potential impact on access to financing by local businesses:** Stakeholders were of the view that de-risking inevitably gives foreign commercial banks in the Federation a “leg up” on indigenous banks with the very likely result that some indigenous banks will not survive. One consequence of the demise of indigenous banks would be a lowering of the access to capital by startup businesses given that foreign banks have a policy that a business must have been operating for a minimum of two years in order to access a loan. Additionally, the lending criteria of indigenous banks are not as stringent as that of foreign banks.

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<sup>82</sup> There were 17 respondents to the survey mainly financial and professional service providers.

**Figure 6**  
**Saint Kitts and Nevis: impact of de-risking on non-bank financials and businesses**  
 (Per cent)



Source: ECLAC survey on the economic impact of de-risking for non banks in Saint Kitts and Nevis.

**Strategies Suggested by Stakeholders in Addressing De-risking:** The feedback from non-bank stakeholders on the main strategies for addressing de-risking focused on enhanced dialogue and compliance. The top three strategies identified were as follows:

- Ensure compliance with international standards on AML-CFT.
- Ensure dialogue between regulators and global financial institutions.
- Strengthen regulations and supervision of domestic banks in line with international standards including forward-looking risk-based supervision.

## G. Outlook

Up to the time of this report (October 2017) the withdrawal of CBS in SKN in 2016 and early 2017 has affected mainly the offshore financial sector. The feedback from the consultations with banking sector stakeholders convincingly identifies the key driver of a retrenchment and threatened withdrawal of correspondent banking services to have been a business decision based on a re-evaluation of risk-reward tradeoffs in light of low profitability.

Pointing to Saint Kitts and Nevis' robust AML-CFT and risk based regulatory frameworks; senior level authorities in SKN are of the view that non-compliance with AML-CFT is not a driver of the reduction in CBS. **Instead, they are of the view that reputational risk arising from the characterization of the offshore financial sectors in the Caribbean as tax havens is the source of the problem in terms of relationships with correspondent banks.** In this regard, CBRs are viewed by banking sector and regulatory stakeholders as having publically cloaked de-risking as a broad AML-CFT concern rather than as a business decision.

As noted earlier, the Federation's sole international bank had lost 2 of its 3 CBRs between January and February 2017. The US correspondent bank communicated only that it was a business decision based on profitability and unrelated to AML-CFT compliance. A large indigenous bank was also threatened with the loss of its US correspondent bank and was able to maintain CBS from the bank by agreeing to guarantee a certain level of profits. This is evidence of differential treatment for large domestic banks that have agreed to minimum thresholds for profitability with the same US correspondent, supporting the view that de-risking was a business decision.

Looking ahead, the on boarding by indigenous banks of clients de-banked by foreign banks including CBI investors heightens their risk profiles with potential implications for risk-based assessments going forward.

Notwithstanding, the fact that de-risking has not yet been a cascading phenomenon for St Kitts and Nevis, the potential consequences are nevertheless daunting. One knock on consequence of the withdrawal of CBS is the unwinding of the offshore sector in Saint Kitts and Nevis. Insurance, trusts and holding companies in the offshore sector initially faced mounting costs to retain CBS. Now these companies face de-banking.

## V. De-risking experience and impacts: case study of Antigua and Barbuda

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The section of the report highlights the main findings of the case study of de-risking on Antigua and Barbuda<sup>83</sup>. The presentation is structure similarly to that outlined in Section 3 on Belize.

### A. Withdrawal of correspondent banking services to Antigua and Barbuda – the experience

The withdrawal of CBS in Antigua and Barbuda (A&B) is viewed by bankers as a phenomenon that has been taking place over the last 15 years in various formats, driven mainly by reward-risk assessments and profit seeking. The earliest impact to the financial sector came in 2000-2003<sup>84</sup> when several large global banks withdrew from the jurisdiction referencing economies of scale and low profitability as their reasons for exiting.

The more recent withdrawal of CBRs was generally thought of as affecting mainly the offshore banks which were viewed as higher risk because the deposit base was international. However, banking sector stakeholders were of the view that correspondent banks were now placing greater emphasis on country and reputational risks. In this regard, country risk and the negative perceptions of offshore centers were driving the current de-risking shock in Antigua and Barbuda.

This perspective notwithstanding, in addition to the de-risking of offshore banks two of the three national banks in Antigua and Barbuda lost CBRs, one in 2016 and the other in January 2017 lost CBS. One national bank received notice as early as 2014 of the termination of letter of credit service from its US correspondent. However, this bank continued to receive other services from its US correspondent though at more than double the fees. The bank was subsequently de-risked by its European correspondent bank in May 2016, indicating low profitability. The second domestic bank was de-risked

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<sup>83</sup> Please refer to the full report should a more comprehensive examination be of interest.

<sup>84</sup> These banks include Chase, Toronto Dominion, Bank of Montreal.

by its US correspondent bank though it was on-boarded by a UK correspondent bank that provided services via its US correspondent bank.

The offshore banks that lost their US correspondent bank indicated that notwithstanding long-term relations with the correspondent little notice was given for the termination of services. The reason provided was that “the services provided were no longer within the strategic focus” of the correspondent<sup>85</sup>. In response, the government authorities wrote a letter and the withdrawal of services to the offshore was delayed for one year.

## B. Structure and state of the financial sector in Antigua and Barbuda

**Composition of the Financial Sector in Antigua and Barbuda:** The onshore financial sector of the A&B is relatively deep<sup>86</sup> and dominated by commercial banks comprising 3 national banks<sup>87</sup> and 3 branches of foreign banks. Additionally, there are 7 credit unions<sup>88</sup> that provide access to formal financial services to depositors and borrowers. There are 12 banks in the offshore financial sector. In term of non-bank financial institutions there were 47 in 2016 which included insurance companies, money transfer businesses and pension funds. These are all regulated by Antigua and Barbuda’s FSRC (see table 4).

**Table 4**  
**Non-bank financial institutions in Antigua and Barbuda, Saint Kitts and Nevis and the ECCU, 2016**

Non-Bank Financial Institutions	Antigua and Barbuda	Saint Kitts and Nevis	ECCU
Total	47	77	572
Insurance companies	25	15	163
Pension funds	7	13	113
Investment funds	1	1	3
Finance companies	0	1	2
Mutual funds	0	2	47
Money transfer businesses	11	11	49
Trust companies	1	29	56
Other	2	5	139

Source: Eastern Caribbean Central Bank.

**Banking Sector Assets:** Antigua and Barbuda’s onshore banking sector is highly leveraged with the assets of banks estimated at 170 per cent of GDP at end-December 2016 (see table 5). Financial leverage has decreased steadily between 2012 and 2015 before declining materially to 151 per cent in 2016. The share of the ECCU assets held by banks in A&B was broadly stable edging down to 21 per cent in June 2017 as compared to 22 per cent on average between 2012 and 2016<sup>89</sup>.

<sup>85</sup> Informally the offshore bank personnel were told that there were no AML issues.

<sup>86</sup> The ratio of broad money to GDP was 82 per cent in 2016 down from an average of 87 per cent in 2012-2015. This is well above the average for countries in LAC—65.2 per cent in 2016.

<sup>87</sup> ABI Bank was intervened by the ECCB in 2011 and liquidated in 2015 and folded into Eastern Caribbean Amalgamated Bank though it remains listed on the ECCB website.

<sup>88</sup> There are no data available on credit union assets and liabilities in aggregate or by institution.

<sup>89</sup> There are not data available on the size and structure of the international banking or other financial institutions in the offshore sector. However, the assets of the offshore banks are estimated by one CEO of an offshore bank in Antigua and Barbuda at about US\$2 billion placed in accounts with CBRs.

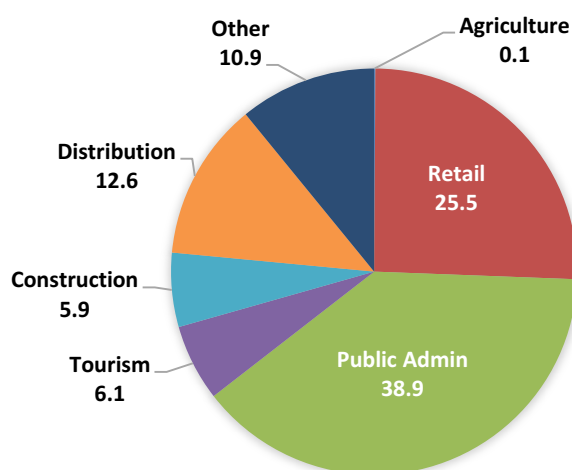
**Bank lending in Antigua and Barbuda:** Consistent with the decline in onshore banking sector assets, lending also declined to EC\$2.4 billion in 2016 or 41 per cent of assets reflecting the earlier economic downturn and ongoing resolution of NPLs. Lending differed markedly between foreign banks and national banks with almost 70 per cent of the loans by the former were personal loans. In comparison, the lending portfolio of national banks was more diversified and included 39 per cent to public administration, 25 per cent to the retail sector, 6 per cent each to tourism and construction and 13 per cent to distribution (see figure 7).

**Table 5**  
**Antigua and Barbuda: total commercial banking sector assets**  
(Millions EC dollars)

	2012	2013	2014	2015	2016	June 2017
National banks (NBs)	1 937.4	1 758.3	1 807.4	1 865.7	1 851.4	1 963.4
Foreign banks (FBs)	3 928.8	3 733.2	3 693.2	4 129.1	4 060.4	4 225.7
Total	5 866.2	5 491.5	5 500.6	5 994.8	5 911.8	6 189.1
Memo Item:						
Average ROA	1.3	0.6	0.4	1.3	1.5	0.4
National banks share of total assets (per cent)	33.0	32.0	32.9	31.1	31.3	31.7

Source: Eastern Caribbean Central Bank.

**Figure 7**  
**National banks' sectoral distribution of loans**  
(Per cent)



Source Eastern Caribbean Central Bank

**Health of the Banking Sector:** In A&B there have been longstanding concerns for asset quality and a high level of NPLs in the system<sup>90</sup>. As noted, banks have been risk averse with respect to taking on

<sup>90</sup> NPLs as a share of total loans had stabilized at 14.5 per cent in 2014, the last year for which data are publically available.



new exposures given the existing overhang of bad loans. This has resulted in a deceleration of economic growth as credit to the private sector since 2011 has been in decline.

### C. Drivers of de-risking in Antigua and Barbuda

Stakeholders were consulted via the surveys and consultations regarding the main drivers of de-risking in the jurisdiction. The following were the main reasons advanced:

- De-risking was a business decision on the part of correspondent banks based on both the small scale and profitability-risk re-assessment and the new and prominent role of country risk.
- The negative image of the jurisdiction associated with its large offshore banking sector.
- The Citizenship by Investment Programs: questions of adequate disclosure and beneficial transparency.
- The AML-CFT frameworks: assessments that there are deficiencies because pre-emptive implementation of the framework in 2005 was not been proactively communicated.
- The fractured nature of regulatory oversight suggesting the need for a single regulatory authority.

### D. The financial regulatory framework in Antigua and Barbuda

As a member of the Eastern Caribbean Currency Union (ECCU) the ECCB serves as the main prudential regulator of both domestic (“national”) banks and foreign owned banks (excluding offshore banks). Similar to SKN the offshore banks and other international financial sector businesses are regulated and supervised by the country’s Financial Services Regulatory Commission (FSRC). The Financial Intelligence Unit of the Office of National Drug and Money Laundering Control Policy (ONDCP) is responsible for receiving, analyzing and dissemination of financial information to competent authorities, particularly as it relates to the proceeds of crime, fraud, embezzlement and money laundering.

Regulators referenced enhanced supervisory framework in place for non-bank financial institutions operating in the offshore sector with disclosure in line with international standards. It was indicated that AML-CFT frameworks were now robust as deficiencies have been addressed with the system moving to a risk-based approach.

However, an IMF assessment in 2015<sup>91</sup> indicated that strengthening AML-CFT in line with international standards was a priority. Specifically, it was advised that further efforts should focus on the compliance and effective implementation of the 2012 FATF standard. In this context, the IMF advised that continuous focus needs to be on preventing financial integrity and security risks related to the newly introduced CBI program. It was noted that Antigua and Barbuda completed its National Risk Assessment Process in 2017. In addition, the ONDCP conducts onsite reviews of entities, bank and non-bank, to identify deficiencies and assist businesses in addressing them.

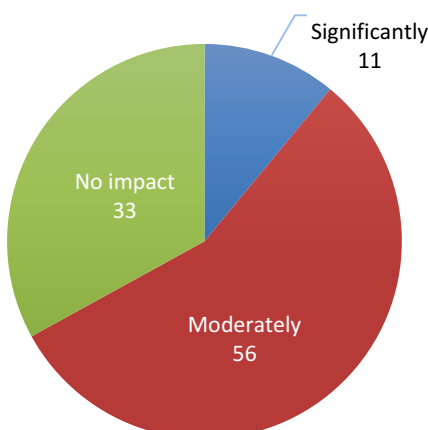
### E. Banking stakeholder feedback on de-risking: impact and comments

The withdrawal of CBSs unsurprisingly has had an adverse material impact on the banking sector of Antigua and Barbuda, both onshore and offshore banks. Among those banks participating in the survey<sup>92</sup> 67 per cent indicated an adverse impact on their operations with 16 per cent reporting significant adverse negative impacts (see figure 8). The main impacts identified by stakeholders are outline below:

<sup>91</sup> IMF, Antigua and Barbuda (2015), p.13.

<sup>92</sup> Ten out of 18 onshore and offshore banks responded to this question.

**Figure 8**  
**Impact of de-risking on respondent banks in Antigua and Barbuda**  
*(Per cent)*



Source: ECLAC survey on the economic impact of de-risking for banks in Antigua and Barbuda.

## 1. General comments/observations of the banking sector stakeholders

- While there was a general sense among stakeholders that the banking sector had moved too slowly in responding to the evolving AML-CFT requirements the response of most banks participating in the survey was that the AML-CFT policies governing banks and the regulatory scrutiny that were now in place far exceeded those in the US.
- Stakeholders were also of the view that there was an uneven playing field with a higher standard for banks operating in the jurisdiction as compared to banks in advanced economies. In this regard, questions were posed concerning the fact that US banks are fined for violations and in the Caribbean accounts are closed. There was also a call for clear guidelines on what Caribbean banks should have in place.
- An overriding concern of bankers was that the withdrawal of CBS would undermine the very objectives that policymakers had been trying to achieve viz: greater participation in the formal financial system. This in turn could lead to a revival of the cash economy in Antigua and Barbuda.
- A representative of a major national bank indicated that the institution did not experience any withdrawal of CBS. The view was that both the bank's scale of operation and the fact that it had strengthened its AML-CFT framework were responsible. The assessment of this stakeholder was that the different risk-management processes across jurisdictions in the region as well as perception of a fragmented regulatory framework pose a problem for correspondent bank risk assessment.
- Bankers expressed a sense of optimism with the entry of a UK correspondent bank into the jurisdiction which would provide CBS via its global US correspondent bank. There was also a sense that other solutions such as crypto currency would materialize if the formal financial system did not provide the services required given that transactions and financial flows are critical to the operation of the economy.

## 2. Specific impact resulting from de-risking

Based on feedback from stakeholders in the banking sector of A&B the following specific impacts associated with de-risking were identified:

- **Products most negatively affected:** most banks indicated that wire transfer services were severely constrained. In this regard, the offshore banks were the most seriously affected by the loss of this service with one bank reporting a loss of wire services in value terms (of US\$129 million) and volume (down to 59 per cent)<sup>93</sup>. Bank respondents also indicated that investment services provided by CBRs were also negatively affected.
- **Increasing Cost of Enhancing AML – CFT Framework:** Given the need for banks to strengthen their AML – CFT framework this undertaking entailed significant costs. In this regard, a major national bank reported an increase in expenses in the range of 20 per cent for this activity.
- **Additional transaction cost & delays re: use of alternative providers of correspondent services:** As in the other study countries, offshore banks and the smaller indigenous banks that had been de-risked were resorting to other jurisdictions and intermediaries. This approach has resulted in both increased costs in the processing of transactions and delays given that different time zones were now in play to execute US dollar transactions.
- **De-banking investors participating in the CBI Program by Foreign Banks:** The two foreign banks that participated in the consultations indicated that although they had not been affected by de-risking as they had terminated the accounts of investors participating in Antigua and Barbuda’s CBI program. These banks assessed that the fact that AML-CFT policies were channeled down from their Canadian parents provided an advantage relative to the situation faced by domestic banks.

## 3. Recommendations by financial sector stakeholders

The main recommendation arising from the consultation discussions with bankers, regulators and policy makers is that banks in the ECCU should amalgamate to provide the economies of scale so that CBRs could earn profits. The second main recommendation is that regulation of the banking sectors in the OECs states should be harmonized and centralized. This was viewed as potentially facilitating transparency in terms of the legislation and mechanisms already in place addressing deficiencies identified earlier.

## F. Impact of de-risking on businesses in Antigua and Barbuda: survey and consultation feedback

The survey results for the non-bank financial and productive sectors indicate that more than half of respondents experienced adverse impacts associated with the withdrawal of CBS from domestic banks (see figure 9). Of those indicating a negative impact, 46 per cent indicated the impact to be significant. It should be noted that some of the survey respondents that had indicated no adverse impacts at the time of the conduct of the survey, during the face to face consultations reported significant negative impacts in the period following the conduct of the survey. An example being credit unions<sup>94</sup> whose customers had wire transfer and check clearing services withdrawn.

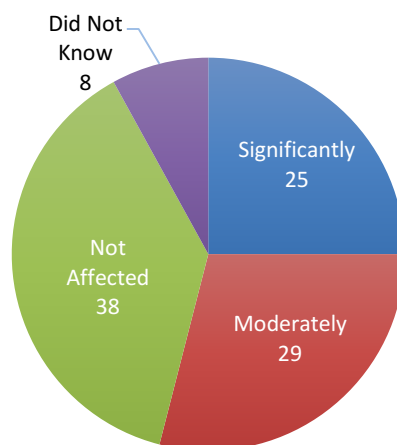
Other financial and professional service providers, including MTSP, insurance companies, trusts and audit and advisory service providers affected adversely by de-risking had strong views concerning the drivers of the withdrawal of CBS. These stakeholders saw the end of the offshore banking sector at

<sup>93</sup> Volume declined from 142 wire transfer per month to 58 per month between 2015 and 2016.

<sup>94</sup> Three credit unions participated in the consultations.

some point in time given the transparency and disclosure required for operating in US dollar transactions. These stakeholders saw merit in conducting regulatory oversight of financial institutions at the regional level.

**Figure 9**  
**Antigua and Barbuda – impact of de-risking on businesses**  
(Per cent)



Source: ECLAC survey on the economic impact of de-risking for non-banks in Antigua and Barbuda.

**Specific Impacts of De-risking on the Non-Bank Business Sector:** Up to the time of the conduct of the survey / interviews stakeholders noted to three main impacts as follows:

- **Increased Cost of doing business:** Several respondents indicated that the costs of doing business had increased arising from the disruption of foreign currency check clearing and wire transfer services.
- **Delays in execution of investment decisions:** The above respondents that experienced increased cost of doing business also indicated that this then leads to delays in executing investment decisions
- **Cost of international banking services to Credit unions:** Credit Unions reported large increases in the cost of the international banking services.

**Recommendations to address de-risking:** Non-bank stakeholders provided suggestions aimed at addressing the problem of de-risking. The top 3 strategies identified focused on enhanced dialogue and compliance. These were:

- Ensure dialogue between regulators and global financial institutions.
- Strengthen regulations and supervision of domestic banks in line with international standards including forward-looking risk-based supervision.
- Ensure compliance with international standards on AML-CFT.

All stakeholders see the need for ongoing and coordinated advocacy campaigns at technical and political levels providing clear evidence that regulatory requirements are being met in line with international standards and also the negative outcomes for meeting the SDGs if de-risking continues as a

major setback for the country. Many stakeholders also see a need to change the negative perceptions of the Caribbean<sup>95</sup> and view the low-hanging fruit in this area to be publishing transparent and current verifiable facts to combat the outdated information online and in current publications. As a region, the Caribbean has a responsibility to ensure that timely and accurate information is available for those making decisions about involvement in the region.

## G. Summary of main findings

The recent episode of de-risking in Antigua and Barbuda began in late 2016 with the termination of CBS by a global US correspondent bank of both onshore domestic and offshore banks. Consultations with stakeholders indicate that the main driver of de-risking of two of three domestic banks is low profitability. The reason provided was that “the services provided were no longer within the strategic focus” of the correspondent. Informally, the US correspondent bank confirmed the main driver to be low profitability with no concerns for AML-CFT. The de-risking of offshore banks has been driven by perceptions of risk arising from mischaracterizations of offshore financial sectors in the region as lacking tax transparency and regulatory frameworks as weak and vulnerable to ML-TF

De-risking has hit Antigua and Barbuda at a time when onshore banks are risk averse with respect to taking on new exposures given the existing stock of NPLs and credit to the private sector [has been sluggish or declining.] Foreign banks in Antigua and Barbuda account for well over 50 per cent of lending with loan portfolios heavily weighted to households. National banks that lend to the productive sector including MSEs and new entrepreneurs have faced a supply shock both in terms of the increased cost of CBS but also ongoing increased costs associated with regulatory compliance.

Beyond the banking sector, de-risking of respondent banks has led to material increased costs of banking services for non-bank financial institutions including credit unions and MTSP. Credit unions have been materially affected by KYCC requirements, notwithstanding the clarification by the FATF in October 2016, in advance of the notifications of the termination of services in November 2016. MTSP have been de-banked with negative implications for their lower income customers.

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<sup>95</sup> Stakeholders referenced programs such as Criminal Minds Beyond Borders and ACMAs which depict the Caribbean in strongly negative terms.

## VI. Conclusion and recommendations

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De-risking in developing economies is not a new financial shock. It has in the past been driven by economies of scale and evaluations of profits against the backdrop of global economic trends including the level of interest rates and also non-economic considerations. The recent episode of de-risking in the study countries has been mainly driven by risk-return considerations in light of small scale and regulatory changes since the financial crisis in the US in 2007. That environment has changed with the recovery of the advanced economies and rising interest rates. Global correspondent banks have rationally reassessed risk-reward tradeoffs albeit in a new global environment which emphasizes AML-CFT and country risk. The interaction of the quest for profits with the changed regulatory environment since 2007 has created a “perfect storm” for developing countries including in the Caribbean that have pursued export-led growth and exposed their economies to the heightened vulnerabilities of openness. In light of the SDGs, financial inclusion and access to international banking services is a basic human right for open economies like the study countries. The downside of inaction is a return to cash economies and informal channels for conducting trade and finance.

Against this backdrop, this study suggests feasible short and medium-term approaches to addressing the challenges.

### A. Short term recommendations

The main short-term broad recommendations are as follows:

- Maintain close relationships with existing correspondent banks and respond effectively to requests for information.
- Financial institutions should join the SWIFT KYC Registry and other information sharing mechanisms to provide a compliance profile within the correspondent bank community.
- Enhance transparency via easy access to current and accurate information on regulatory frameworks, tax transparency and compliance with international standards to ensure information is available to those making decisions about involvement in a jurisdiction.

- Take pre-emptive actions against possible de-risking including by the preparation of de-risking preparedness and response plans.
- “Ramp up” advocacy efforts at all levels to sensitize relevant actors that de-risking is a material financial shock with the potential impact on GDP akin to that of a hurricane shock.

## **B. Medium term recommendations**

They include:

- Launch a transparency and media campaign to address the misperceptions and misreporting on the regulatory frameworks and tax transparency of countries potentially vulnerable to de-risking. This includes fact checking the information available on foreign official websites.
- Consolidate banks and banking systems in the Caribbean to improve the profitability of providing CBS in small countries.
- Examine alternative strategies including the use of digital currency technology and currency substitution e.g. dollarization.
- Strengthen AML-CFT regimes so that they are “water tight” as these requirements evolve as a necessary but not sufficient requirement for maintaining CBRs. Secure greater representation in standard setting fora.
- Collaborate on advocacy initiatives targeting the most senior policy and executive levels to facilitate steps toward a more reasoned approach to the withdrawal of CBS from a jurisdiction.
- Undertake analysis to estimate the actual contribution of offshore financial sectors and export free zones to the economy.

There may indeed be valid reasons for correspondent banks to exit a jurisdiction where there are either valid AML-CFT risks and or/ low profitability. However, there needs to be a framework for fostering orderly work outs of the withdrawal of CBS and CBRs including policy interventions so that no jurisdiction remains without CBS given the link between the provision of these services, GDP growth and wellbeing.

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