



U.S. House Committee On Financial Services

Hearing on

**When Banks Leave: The Impacts of De-Risking on the Caribbean and Strategies
for Ensuring Financial Access**

**Wednesday, September 14, 2022, 10:00 a.m.
2128 Rayburn House Office Building & WebEx**

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Chairwoman Waters, Ranking Member McHenry, and distinguished members of the Committee, it is my privilege to address you at today's hearing on the topic of de-risking. Thank you for prioritizing this important topic. Today, I will focus my testimony on (1) why de-risking happens; (2) the consequences of de-risking; and (3) how technological innovations can help minimize the practice of de-risking.

My name is Liat Shetret. I am the Director of Global Policy and Regulation at [Elliptic](#), the global leader and provider of anti-money laundering compliance solutions to virtual asset businesses and regulators globally for nearly a decade. We equip financial institutions, cryptoasset businesses, law enforcement and regulators with the tools and insights they need to manage risk, including for example, to identify, assess and act upon illicit and criminal crypto transactions recorded on the blockchain. Elliptic makes sense out of blockchain data, and identifies trends and typologies that help our customers understand and evaluate their risk exposure, and make risk-based decisions.

De-risking is Not a New Issue

In 2015, I co-authored a report – commissioned by Oxfam U.S. – titled [Understanding Bank De-Risking and Its Effects on Financial Inclusion](#). In that report, we explored the drivers and responses to de-risking, highlighted case studies of financial access and provided recommendations for banks, regulators and bank customers who have been de-risked. Not much has changed in terms of the complexity and detriment of the de-risking problem. However, the urgency for addressing de-risking of correspondent banking relationships – specifically in the Caribbean and other regions – is significantly heightened.

De-risking – or de-banking – refers to the practice of financial institutions exiting relationships with and closing the accounts of clients perceived to be “unacceptably risky” or “high risk” based on the bank’s risk tolerance. Rather than manage these risky clients, financial institutions may opt to end the relationship altogether, consequently minimizing their own risk exposure while leaving clients without access to the global banking system. According to the World Bank, there are over 1.4 billion people globally who are either unbanked or underbanked.

A 2021 survey from the World Bank revealed that over 37% of people cite cost as a primary barrier to banking. That number was nearly twice as high (60%) in Latin America and the Caribbean. Access to banking products has major implications not only for a country’s financial resilience, but also its ability to access money in an emergency such as a natural disaster. There is also a stark gender gap in financial resilience in the Caribbean, where 56% of men can reliably access emergency money, but only 39% of women report being able to do so.

While de-risking practices have not been localized in any particular population, community or industry, in recent years there has been an “aggregation of results” best described as a trend toward de-risking of sectors, including correspondent banks and specific financial corridors and regions. These account closures have had a ripple effect on financial access for individuals and businesses who rely on access to financial services with regional and national security implications.

Drivers of De-risking

Financial institutions have significantly scaled back their risk appetites. These declining risk appetites – coupled with rising global scrutiny of anti-money laundering/countering the financing of terrorism (AML/CFT) – are the most commonly cited reasons for de-risking. Digging deeper, we note that underlying the practice of de-risking is the assumption that the affected customers present a higher risk of utilizing bank accounts as a medium for raising, moving, and storing funds that are somehow tainted by illicit activities such as money laundering, terrorist financing or tax evasion.

Specifically, correspondent banks – which provide back-end services such as check clearing, foreign exchange trading and fund transfers on behalf of other financial institutions – have been identified as a key vulnerability in AML/CFT regimes and are being de-risked. Profitability is also a factor in assessing correspondent banking relationships. In short, the risk is simply not worth the reward.

Consequences of De-risking and the Regulatory Response

De-risking is an issue that impacts the entire market. All invested stakeholders, banks, regulators and bank customers and clients appear to be acting rationally and in their own best interest. However, in doing so, they have created unintended consequences for market integrity, financial inclusion goals, AML/CFT objectives, and worryingly, compromised national security interests. This is because the risks are not being mitigated. Instead, risk is shifted to less visible places within the traditional banking system, so-called shadow banking - or outside of it altogether - something referred to as re-risking.

A lack of structured and systemic response to the issue of de-risking is perpetuating the challenge of regulatory arbitrage - the practice of utilizing more favorable laws in one jurisdiction to circumvent less favorable regulation elsewhere. Additionally, it potentially opens the door for China's implementation of its so-called Belt and Road Initiative - an expanded, interdependent market, designed to grow and build its economic power vis a vis mega-infrastructure and technology applications.

International standards urge financial institutions to adopt a risk-based approach (RBA). Regulators proactively advise financial institutions to assess their money laundering and terrorist financing vulnerabilities and to formulate policies and allocate resources according to their unique risk profiles and risk exposure. Although this approach is designed to allow for flexibility, it also introduces ambiguity and immense subjectivity around which actions are in fact required to meet international AML/CFT standards. Inappropriate risk avoidance has replaced effective risk management.

Rather than reducing the risk of criminal activity in the global financial sector, de-risking potentially increases systemic vulnerability. Pushing high-risk clients to become nested accounts in smaller financial institutions that may lack adequate AML/CFT capacities and controls. De-risking reduces visibility by well-regulated global institutions. Such a consequence was almost certainly not intended when the RBA was implemented and objectively does not increase security.

Conversely, financial inclusion is part of a broader strategy to reduce poverty, encourage economic development and promote access to financial services. The goals of financial inclusion, and adherence to AML/CFT obligations are not inherently in conflict. But tensions do emerge in practice. The international focus on financial inclusion - and simply "treating-customers-fairly" - has coincided with increased attention to AML/CFT frameworks, positioned as critical tools for advancing stability and security objectives, and for curbing criminal activity.

So how can these objectives be balanced?

Innovation and Technological Solutions to De-risking

De-risking is a problem of exclusion that is remedied by inclusion – specifically, the inclusion of actors and technology. For the Caribbean, convening an action-oriented task force or committee of affected parties – including financial institutions, regulators and trusted members of the private sector such as tech companies – will bring innovative solutions to historically challenging problems.

Congress should explore legislation to facilitate the acceleration of digital identification – offering clarity and certainty to an antiquated banking concept. As the digital economy has evolved, the need to update and expand the definition of compliance concepts such as customer due diligence and know your customer (KYC) rules has increased. Identity management now must consider reconciling online identities with offline identities as well as account for individuals who remain without identification altogether. New legislation should explore KYC elasticity – the idea that these rules can be expanded to fit economic developmental and security realities straddling digital and traditional markets. Improving access to financial services through technological improvements to authentication of identity can lower barriers to entry for those who are unable to access these services due to identification requirements.

Congress should expedite the exploration of blockchain-based tech solutions that enhance US dollar dominance globally – including stablecoins and central bank digital currencies (CBDCs). This will ensure that market efficiency, privacy concerns and interoperability with other economic blocs – such as with the Caribbean counterparts – will be well-considered,

CBDCs have an extremely high adoption rate in the Caribbean, with eight Eastern Caribbean countries having fully deployed one. As the US continues to explore the development of its own Digital Dollar, interoperability with other nations' CBDCs should be prioritized as a means to strengthen US competitiveness in the global economy and dramatically improve the deployment of capital to these regions.

Regulators should consider balancing punitive measures – such as sanctions, penalties and fines – with constructive models that reward risk mitigation through innovation, recognizing attempts to promote financial inclusion while retaining a robust approach to market integrity. Regulatory sandboxes allow the use of new regulatory tech and supotech tools such as blockchain analytics to be explored and enhanced, while reducing the impact on the broader financial system.

AML/CFT supervisors and prudential regulators should further leverage US delegations' engagement at international foras. For example, US representatives and counterparts at the Financial Action Task Force (FATF) and their regional counterparts,

or other AML/CFT forums can push to expand on the risk-based approach. The provision of clear rules, or principles-based guidance where relevant to provide clarity about AML/CFT requirements involving those clients deemed inherently high risk will go a long way. Similarly, to promote the continued integration of financial inclusion into mutual evaluation methodologies developed by the FATF and the World Bank, national regulators should foster holistic strategies for the evaluation of money laundering, terrorism finance and financial inclusion.

Financial institutions could enhance their focus on corporate social responsibility by adopting strategies which are by nature more inclusive, relying on individual circumstance, nuanced customer due diligence and transaction monitoring than broad risk tiers or sectoral or jurisdictional assessment.

The banking sector could use the Wolfsberg Group and other industry fora to establish guidelines that enable effective compliance practices for dealing with crypto businesses. This will, for instance, allow banks to manage the risks while avoiding de-risking.

Blockchain analytics provide an example of how an innovative approach can work in practice to increase systemic security and enhance inclusivity. Blockchain-based accounts offer unique innovations such as end-to-end visibility of funds, showing where money *has* been and where it is going. They also allow for the pre-screening of an account before funds can be withdrawn and help identify potential exposure to sanctions. These are all blockchain-based innovative capabilities that are simply not possible with traditional finance.

Many challenges remain in addressing the balance between financial integrity and inclusion. However, there are also many opportunities to address these issues by operationalizing public-private sector initiatives that address concepts such as identity and transaction monitoring. Moving into a digitized economy gives banks the opportunity to innovate, manage and mitigate risks effectively. Tech innovations serve as an enabler to every stakeholder involved in the de-risking conundrum.

Thank you for the opportunity to speak here today and I welcome your questions, discussion and follow up.

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