



## PACIFIC ISLANDS FORUM SECRETARIAT

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### FORUM ECONOMIC OFFICIALS MEETING

6 – 7 July 2021

### FORUM ECONOMIC MINISTERS MEETING

13-14 July 2021

Virtual

#### AGENDA ITEM 9C: CORRESPONDENT BANKING ISSUES IN THE PACIFIC

##### **Purpose**

This paper seeks to prompt discussion on the withdrawal of correspondent banking services from the Pacific and seek Ministers' endorsement to revert to FEMM with further recommendations.

##### **A. Issue**

Correspondent banking relationships connect countries to the international financial system. By facilitating domestic and cross-border payments and currency exchange, they enable trade, aid, foreign investment, and remittances. However, correspondent banking relationships globally are in decline due to rising risk management and compliance costs resulting from anti-money laundering and countering financing of terrorism (AML/CFT) requirements, general profitability, reputational risks. This trend, known as de-risking<sup>1</sup>, can be justified where a bank lacks the capability to provide effective due diligence. However, in many cases, de-risking policies among correspondent banks have resulted in a loss of access for many small banks without consideration of the broader negative consequences.

2. While the factors driving de-risking are global, the impact in the Pacific is more acute. This is in part due to the relative importance of remittances to the region as well as the limited number of correspondent banking relationships, challenging commercial conditions, and immature regulatory compliance and capabilities<sup>2</sup>.

3. The potential consequences of the continued withdrawal of correspondent banking relationships throughout the Pacific are significant. In the extreme case, the loss of correspondent banking relationships could severely limit a nation's access to the global financial system, and with it the ability to perform the basic payment and currency exchange transactions which facilitate remittance and trade. Many people could lose access to payment and remittance services, while others might turn to unregulated payment options outside of the formal banking sector. Even if the extreme case is avoided, continued decline in access to correspondent banking in the Pacific could see prices for cross-border banking services rise, and may increase financial stability risks.

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<sup>1</sup> "De-risking" is a process whereby banks opt to close correspondent bank accounts rather than investing in the due diligence that is necessary to operate them responsibly.

<sup>2</sup> For example, a number of Pacific island countries have only one USD clearing relationship.

As the number of active correspondent banking relationships falls, while the volume and value of payments continue to rise, the concentration of services increases.

4. While the rate of retreat of correspondent banking relationships appears to have plateaued in many parts of the world, this is not the case in the South Pacific. In 2019, the number of active cross-border correspondents fell by 11 percent in Melanesia and 9 percent in Polynesia, compared to a global decline of 3 percent. Data for 2020 and beyond are not yet available. However, emerging reports indicate that the retreat of correspondent banking relationships has continued, and even accelerated in some parts of the Pacific. The contraction in the network has reached a critical level where some domestic Pacific banks may find themselves cut off from safe, reliable, affordable access to the global financial system.

## **B. A way forward**

5. An unintended consequence of global AML/CTF regulations is that banks are avoiding, rather than managing, risk. Support from government and multilateral institutions is needed to build up capacity in the Pacific to engage with and reduce risk, especially for local Pacific banks.

6. In particular, Forum Economic Ministers are encouraged to consider policy actions to strengthen the financial and banking sector to improve the risk profile of Pacific jurisdictions, which may include enhancements to relevant legislative frameworks and/or resourcing for financial sector supervision and regulatory enforcement. Issues relating to tax, the treatment of international companies, money laundering and corruption, and the capability and performance of local Pacific banks, especially those that are government-owned, could be considered as part of such actions.

7. To assist Members in this regard, it is suggested that a working group of members is established to consider the issue and report back to the next Forum Economic Ministers Meeting. The working group could identify a multilateral implementing partner, potentially the Asian Development Bank, to assist with reporting back to the Forum Economic Minister's Meeting with a plan response.

Submission by the Government of Australia  
6 July 2021