

# INTERNATIONAL AND DOMESTIC IMPLICATIONS OF DE-RISKING

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## HEARING BEFORE THE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT OF THE COMMITTEE ON FINANCIAL SERVICES U.S. HOUSE OF REPRESENTATIVES ONE HUNDRED FIFTEENTH CONGRESS SECOND SESSION

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# CONTENTS

	Page
Hearing held on:	
June 26, 2018 .....	1
Appendix:	
June 26, 2018 .....	33

## WITNESSES

TUESDAY, JUNE 26, 2018

Clements, Michael E., Director, Financial Markets and Community Investment, Government Accountability Office .....	3
Eckert, Hon. Sue E., Adjunct Senior Fellow, Center for a New American Security .....	5
Haddad, Gabrielle, Chief Operating Officer, Sigma Ratings, Inc. ....	7
Lewis, John, Senior Vice President, Corporate Affairs and General Counsel, United Nations Federal Credit Union on behalf of the National Association of Federally-Insured Credit Unions .....	9
Yearwood, Sally, Executive Director, Caribbean-Central American Action .....	11

## APPENDIX

Prepared statements:	
Clements, Michael E. ....	34
Eckert, Hon. Sue E. ....	64
Haddad, Gabrielle ....	96
Lewis, John ....	103
Yearwood, Sally ....	114



## INTERNATIONAL AND DOMESTIC IMPLICATIONS OF DE-RISKING

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**Tuesday, June 26, 2018**

U.S. HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS  
AND CONSUMER CREDIT,  
COMMITTEE ON FINANCIAL SERVICES,  
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 2:02 a.m., in room 2128, Rayburn House Office Building, Hon. Blaine Luetkemeyer [chairman of the subcommittee] presiding.

Present: Representatives Luetkemeyer, Rothfus, Posey, Pittenger, Barr, Tipton, Williams, Love, Loudermilk, Kustoff, Tenney, Clay, Scott, Green, and Crist.

Chairman LUETKEMEYER. The committee will come to order. Without objection the chair is authorized to declare a recess of the committee at any time. This hearing is entitled, "International and Domestic Implications of De-risking."

Before we begin I would like to thank the witnesses for appearing today, we appreciate your participation and look forward to the discussion.

I now recognize myself for 5 minutes to deliver my opening statement.

This subcommittee has spent significant time analyzing the impact of de-risking on consumers, businesses, and entire communities. As we have discussed, the overly punitive supervisory and examination tactics employed by Federal financial regulators that came in the wake of the financial crisis have had dramatic implications on the availability of financial products and services in all of our communities.

What we have not discussed are the global implications of these regulations. Today we will not only explore de-risking's impact on U.S. financial institutions and their customers but also its impact on people and businesses around the world as well as our fight to combat illicit financial activity. Making relationships with so-called high-risk clients, they become cost prohibitive for financial institutions due, in large part, to heightened compliance expectations, and as a result many institutions have opted to terminate relationships.

This decision has resulted in the elimination of the consumer and small business access to financial products and services, a decrease in the availability of money remittances, and reduced flow of humanitarian aid globally.

To be clear, there are valid reasons for account terminations and the fight against illicit finance is one of the most important fights

we wage; however, we would be better equipped to wage that fight if we had a modernized regulatory system.

It is particularly true in the case of compliance with the Bank Secrecy Act and Anti-Money Laundering laws. The truth of the matter is that compliance with BSA/AML is so costly and the penalty is so steep, financial institutions would sooner rather end customer relationships than run the risk of running afoul of the regulators and law enforcement.

The status quo doesn't foster a safer system and it doesn't necessarily help catch more bad actors; in fact, it is quite the opposite. Instead of fostering collaborative relationships between institutions and government, the modern BSA/AML framework, along with the other regulatory drivers of de-risking, push more people and more money into the shadows.

So where do some of those de-bank customers go? According to data published last year by payment and compliance technology company Accuity, correspondent banking relationships with Chinese banks surged more than 3,300 percent, from 65 in 2009 to 2,246 in 2016. There was a 25 percent drop in the number of correspondent relationships globally during the same time period.

It is in the best interest of our financial services firms, our communities, law enforcement, and the Federal Government to monitor and maintain these global banking relationships. This hearing isn't only important to the people testifying today or to the financial institutions that do business internationally, it is important to any small nation that relies heavily on the U.S. dollar and the trading partners who sell U.S. goods there.

It is important to poorer communities that are losing banks and credit unions because of the BSA/AML regime. It is important to a worker in Florida who can no longer send the money he earns to help his family in Haiti. This is an incredibly important topic.

We have an excellent panel today and I want to thank each of them for taking time to testify and we look forward to your statements.

The Chair now recognizes the gentleman from Missouri, Mr. Scott excuse me, who is subbing for Mr. Clay, the Ranking Member of the subcommittee, for a 5-minute opening statement.

Mr. SCOTT. Thank you very much Chairman Luetkemeyer for organizing today's hearing.

And to each of our outstanding panelists for this testimony, we are looking forward to hearing from you.

First of all, it is clear that the push by depository institutions' decisions to de-risk and discontinue account services for certain customers is having very significant, adverse consequences on a broad range of consumers, industries, and regions around the world.

And in addition to the devastating regional impacts the de-risking of broad categories of customers' accounts, has also had an impact on key consumer groups that perform essential functions in our society. This includes nonprofit organizations, charities, embassies, and remittance providers among others; although the adverse effects of de-risking are clear, what is less apparent are the specific factors and the degree to which each factor is responsible for arriving at this trend.



We look forward to the hearing, hopefully we can come up with some very good recommendations as to how we go forward. Thank you again to each of the panelists for being here.

And I yield back the balance of my time.

Chairman LUETKEMEYER. The gentleman yields back.

Today we welcome the testimony of Mr. Michael Clements, Director, Financial Markets and Community Investment, U.S. Government Accountability Office; the Honorable Sue Eckert, Adjunct Senior Fellow, Center for a New American Security; Ms. Gabrielle Haddad, Chief Operating Officer, Sigma Ratings, Inc.; Mr. John Lewis, Senior Vice President for Corporate Affairs and General Counsel, United Nations Federal Credit Union and on behalf of the National Association of Federally Insured Credit Unions; and Ms. Sally Yearwood, Executive Director of Caribbean-Central American Action (CCAA).

Each of you will be recognized for 5 minutes to give an oral presentation or a testimony. Without objection each of the written statements will be made part of the record.

Just two quick housekeeping things. Number one, we have votes called right around 3:30 to 4. We will see where we are with our witnesses' testimony and our questions but we may have to ask you to stay a little longer if we need to go vote and come back.

In the meantime, the timing system on your microphones there are such that green means go, yellow means you have about a minute left, and red means your time is up and so you need to wrap it up very shortly.

So, with that Mr. Clements you are recognized for 5 minutes. Excuse me you are—

#### STATEMENT OF MICHAEL CLEMENTS

Mr. CLEMENTS. Chairman Luetkemeyer.

Chairman LUETKEMEYER. Recognized for 5 minutes. I am sorry.

Mr. CLEMENTS. Chairman Luetkemeyer, Mr. Scott, and other Members of the subcommittee, I am pleased to be here today to discuss our recent report, discussing de-risking by depository institutions and the implication for the southwest border region and money transmitters serving fragile countries.

My statement today focuses on three key findings from our reports. As background, the Bank Secrecy Act serves an essential function, it helps to prevent money laundering, terrorism financing and other criminal activity.

We define de-risking as the practice of depository institutions limiting services or ending relationships with customers in response to perceived regulatory concerns.

Chairman LUETKEMEYER. Mr. Clements, if you could move the microphone, just pull right in front of and just take a bite at it when you speak—

Mr. CLEMENTS. OK.

Chairman LUETKEMEYER. Thank you.

Mr. CLEMENTS. Our first key finding, the extent of and reasons for account terminations and bank closures in the southwest border region. We found that branch closures in the southwest border region were concentrated in a small number of communities. Five counties in Arizona, California, and New Mexico lost 10 percent or

more of their branches. In some instances, those losses were concentrated in smaller communities. For example one California town lost five of its six branches.

The loss of bank branches can have negative implications for business lending and ultimately employment in these communities. In many instances banks limit service or terminate accounts in response to legitimate BSA concerns. The southwest border region poses a high risk for money laundering because of the high volume of cash transactions, number of cross-border transactions, and number of foreign account holders.

However, we also found evidence of de-risking, in particular 80 percent of southwest border banks reported limiting or not offering of accounts because the customer type drew heightened BSA regulatory oversight. Here the reason is perceived oversight, not the customer's action.

Our second key finding, the challenges money transmitters face remitting funds to select fragile countries. We examined the experience of money transmitters serving four fragile countries: Haiti, Liberia, Nepal and Somalia. Remittances from the United States are an important source of funds for these countries. All 12 money transmitters we interviewed that served these countries report losing some accounts with banks. In the case of Somalia, two of four money transmitters report losing all access to bank accounts.

Some banks acknowledge closing and denying accounts for money transmitters. These banks consider money transmitters high cost and also high-risk customers. In particular banks cite: One, high staff and technology cost associated with BSA-related activities; and two, the perceived risk of significant fines and penalties.

Money transmitters that lose access to banking services often resort to nonbanking channels such as couriers physically transporting cash. For law enforcement, nonbanking channels provide less transparency and thereby hinder the ability to detect criminal activities.

Finally, our third key finding, agencies' efforts to assess and respond to de-risking concerns. Treasury and Federal banking regulators have taken some steps in response to concerns about de-risking. The agencies have issued BSA guidance to banks. The agencies have also conducted retrospective reviews; these are a lookback to assess whether regulation should be retained, amended, or rescinded. However, we found the agencies' reviews have not fully addressed the factors that influence banks to de-risk.

The agencies also recently began collecting data on international remittances from banks. However, we found Treasury does not have the data it needs to assess how the loss of banking services by these remitters will influence service to fragile countries.

Given the problems we identified, we made several recommendations. We recommended that Treasury and the banking regulators conduct retrospective reviews that incorporate banks' regulatory concerns regarding BSA/AML compliance. We recommended that Treasury assess the extent to which remittance flows through non-banking channels may hinder its ability to monitor criminal activity.

Chairman Luetkemeyer, Mr. Scott, and other Members of the subcommittee, this completes my prepared statement. I would be pleased to respond to any questions you may have.

[The prepared statement of Mr. Clements can be found on page 34 of the Appendix.]

Chairman LUETKEMEYER. Thank you. Mr. Clements yields back the balance of his time.

Then we go to Ms. Eckert. You are recognized for 5 minutes. Welcome.

#### STATEMENT OF SUE ECKERT

Ms. ECKERT. Thank you. Chairman Luetkemeyer, Congressman Scott, and distinguished Members of the subcommittee, thank you for the opportunity to testify today on the international and domestic implications of de-risking.

I applaud your efforts to call attention to the critically important phenomena of de-risking—something that is not well understood but which has profound impacts on some of the world's most vulnerable populations. The U.S. has a unique role to play in addressing de-risking globally as the dominance of the U.S. dollar and American regulatory policy set the stage for other countries.

My comments today focus on the impact of de-risking on charities and nonprofit organizations and is based on the research that I conducted for the February 2017 report, Financial Access for U.S. Nonprofits. It was commissioned by the Charity & Security Network and supported by the Bill and Melinda Gates Foundation. While I am currently involved with the World Bank ACAMS (Association of Certified Anti-Money Laundering Specialists) process on financial access for NPOs (non-profit organizations), the views expressed today are my own.

I spent a number of years on Capitol Hill as a staffer in the Executive branch as a regulator of dual-use exports and in the academic community but in all those years there is no issue that I dealt with that has more serious, real, and dire consequences for populations in need. These severe implications extend beyond NPOs and the groups that they serve; it also extends to U.S. security and foreign policy interest. So with my brief time I want to make a couple points.

First, there is no question of the need for humanitarian and development assistance today, it is a profound need. The United Nations estimates that in 2018, more people than ever before will need assistance and protection, 136 million people. Conflict, protracted crises, and natural disasters continue to be the main drivers of need, which remains exceptionally high levels in countries such as Nigeria, South Sudan, the Syria region, and Yemen which are likely to remain the world's most serious humanitarian crises.

To effectively respond to these humanitarian crises, funds must be able to move across borders in a timely and predictable fashion. Financial access for charities and NPOs, therefore, can literally mean life and death.

Second, there is no question that de-risking or problems with financial access for NPOs is having a serious and widespread effect. The study from 2017, noted surprisingly that two-thirds of all U.S. NPOs were having financial access difficulties, perhaps more worri-

some was the fact that in order to respond and get the aid to these places, 42 percent of NPOs were starting to carry cash because they could not get money through the financial system. We actually have more recent data that shows that the problem appears to be worsening.

Third, the problem relates to concerns by financial institutions for the risk and cost associated with banking in the charitable sector. This derives from well-intended and important policies developed immediately after 9/11 by the FATF (Financial Action Task Force), whereby NPOs or charities, were considered particularly vulnerable to terrorist abuse.

Based on more recent analysis, the evolving nature of the terrorist threat and actions that the charitable sector has taken, that perception is outdated and, in 2016, FATF changed its policies. However, the pervasive nature of the perception that charities are high risk persist; serious unintended consequences of these policies have resulted.

Fourth, de-risking is a complex problem that entails a variety of interest: Financial integrity; national security and counterterrorism; foreign policy; and the provision of humanitarian and development assistance and it must be a shared responsibility. No one group, U.S. policymakers, U.S. regulators, financial institutions, or the nonprofit and charitable sector, can address these issues by themselves.

Fifth, in terms of what kind of action should be taken, very briefly, raise awareness and promote a balanced approach; stakeholder dialog which the World Bank and ACAMS has promoted, has enhanced engagement among all parties. What is really interesting is how little these sectors know of each other.

The second is to provide regulatory and policy guidance. The government needs to develop policy and regulatory guidance that provides clarity to banks and NPOs on the implementation of a risk-based approach; however, 2 years ago when FATF adopted the recommendation, changed the nature of how charities should be treated, nothing has happened subsequently. Banks have told us there is no question that they have to have something from the regulators in order to change their assessment of risk.

Currently the World Bank and ACAMS initiative has produced recommendations that were jointly made by banks and nonprofits, which is pending before the regulatory agencies.

Third, we need to explore incentives for financial institutions to bank NPOs. A menu of measures including the creation of safe harbor to incentivize banks to keep NPO accounts and encourage efforts to engage with NPOs should be developed.

Finally, the creation of safe-payment channels. There are times when banks are not going to go any further and we need to consider those options.

There are additional recommendations in my statement. Mr. Chairman, I look forward to discussing them.

[The prepared statement of Ms. Eckert can be found on page 64 of the Appendix.]

Chairman LUTKEMEYER. Thank you.

Ms. Haddad, you are recognized for 5 minutes.

### STATEMENT OF GABRIELLE HADDAD

Ms. HADDAD. Thank you. Chairman Luetkemeyer, Congressman Scott, and distinguished Members of the subcommittee, I am honored by your invitation to testify before you today.

De-risking is a phenomenon that has had dramatic impacts on the international financial system over the last decade. De-risking has impacted the concentration of trade flows and cross-border payment activity which challenges financial stability and inclusion for affected markets.

For the United States specifically, a decline in dollar-denominated transactions and flows through U.S. financial institutions has potential implications on commerce as well as the United States' competitive position.

I am the Co-founder and Chief Operating Officer of Sigma Ratings, a company we founded to address de-risking by highlighting and incentivizing good corporate behavior globally. Today my testimony will focus on the drivers and international impacts of de-risking that resulted from the termination of correspondent banking relationships.

Since founding Sigma Ratings, my team and I have met with financial institutions and regulators in dozens of countries across Europe, Latin America, the Middle East, and Africa to better understand the challenges of de-risking and determine how our solution can help solve them.

We have learned that there are many drivers of de-risking including profitability and reputational risk concerns and these drivers may vary from country to country; however, fears of regulatory enforcement actions and fines as well as the cost associated with complying with anti-money laundering, counterterrorist financing, and sanctions regulations, are consistently highlighted as primary drivers of de-risking.

Regulatory fines imposed since 2012 against global banks reached billions of dollars and have had a chilling effect on the robustness of global correspondent relationships. The magnitude of these fines has instilled fear in many global banks and resulted in the reassessment of those banks' risk appetites.

Another driver is cost. Global banks are spending billions of dollars a year on compliance with some banks individually spending over a billion dollars themselves. Cost of due diligence and concerns about the compliance regimes of respondent banks are frequently mentioned as the main reasons for termination.

While much of bank-spending is for critically important tasks, many costly compliance tasks are repetitive and viewed as mere check-the-box exercises by banks. This may distract institutions from the intended outcome of detecting real risk and ultimately identifying illicit activity. As a result of these fears and costs, many institutions determine that the costs and risks associated with maintaining certain relationships are no longer worth the revenue generated, leading to terminations.

I would like to turn to the three key consequences of de-risking: Financial exclusion, decrease in transparency, and long-term effects.

First, research demonstrates that de-risking has direct financial implications for individuals and businesses operating in these mar-

kets. In a World Bank report from November 2015, decreases in lending, international wire transfers, cash management services, and check-clearing were highlighted among some of the most significant impacts at the local level. Additionally, an IMF report from March 2017 indicates that small countries with low volumes of transactions experienced increased costs for remittance transfers which has a direct impact on end-users.

Second, it has been cautioned by the World Bank, the Financial Action Task Force, and other groups, that de-risking may unintentionally drive financial transactions underground or into shadow markets. This makes detecting illicit activity much harder. It is well-documented that channels with a low likelihood of detecting illicit activities such as unregulated industries are the channels more frequently used by money launderers and terrorist groups for movement of funds. As regulated entities, banks have higher likelihood of detecting illicit activity.

Third, de-risking has long-term effects that should not be ignored. We found in our research that many countries and institutions that were de-risked continue to struggle to find new relationships and for those who do, they are often subject to higher fees and increased due diligence by correspondents leading to higher costs of doing business.

The loss of correspondent banking relationships can also create a long-term stigma, for example, rating agencies have started to consider loss of correspondent banking relationships as a factor for downgrading the rating of a financial institution.

With de-risking and its drivers receiving much attention over the last few years, with public and private sector players have presented potential solutions, a sustainable solution, however, will require a change in the overall cost-benefit analysis for correspondents in high-risk markets.

Some possible approaches are the following: First greater sharing of risk information to improve overall transparency and reduce due diligence costs. For a bank with thousands of relationships, due diligence practices, much of which are done manually today, are almost impossible to keep up with. Greater information sharing between both public and private sector improves information availability and transparency.

Second, the compliance burden can be further reduced through the use of standardized, independent third-party assessments of potential respondents' risk and compliance practices. An independent assessment would serve as a baseline for a correspondent to enter into a relationship, thus reducing much of the up-front and ongoing diligence processes.

Furthermore, standardized assessments would allow for benchmarking across jurisdictions, for use by governments as well as financial institutions. This increased visibility and comparability would allow for better allocation of capacity-building resources.

Finally, the use of technology to enable financial institutions to better understand their clients and manage their risk should be welcomed.

Thank you for taking the time to hold this hearing and for allowing me to share my perspective on this important topic. I look forward to your questions.

[The prepared statement of Ms. Haddad can be found on page 96 of the Appendix.]

Chairman LUETKEMEYER. Thank you, Ms. Haddad.

Mr. Lewis you are recognized for 5 minutes, hopefully it is within a 5-minute timeframe.

#### STATEMENT OF JOHN LEWIS

Mr. LEWIS. We will try.

Chairman LUETKEMEYER. We have a difficulty with 5 minutes today.

Mr. LEWIS. Good afternoon Chairman Luetkemeyer, Ranking Member Clay, and Members of the subcommittee.

My name is John Lewis. And I am testifying today on behalf of NAFCU. I am the Senior Vice President of Corporate Affairs and General Counsel for the United Nations Federal Credit Union.

NAFCU and its member credit unions have consistently recognized the importance of BSA and AML requirements in assisting in prevention of illicit activity. Credit unions are fierce supporters of efforts to combat criminal activity utilizing our financial systems. Credit unions work closely with examiners to ensure consistent application of BSA risk assessments. Still, the implementation of BSA requirements remains a burden for many credit unions especially in the post-financial crisis regulatory environment.

Given credit union's field-of-membership limitations, it is important for credit unions to have potential to serve everyone in their field of membership whether individuals or legitimate businesses, some members may present heightened-risks which can mean increased compliance burdens, cost, and pressures on credit unions.

Despite UNFCU's unique field-of-membership, we have been fortunate to have good relationships with our examiners who have worked with us in riskier areas. However, other credit unions report that while NCUA (National Credit Union Administration) doesn't directly prohibit them from serving certain types of members, they feel pressured by examiners to limit services.

It is important to note that when a credit union is serving a higher-risk individual or business, they are very thorough in their evaluation recordkeeping. However, when examiners evaluate that relationship they can be very demanding of the credit union, this additional pressure and scrutiny from examiners can lead institutions to de-risk by limiting services for certain types of members.

Sometimes the pressure to de-risk comes not from the regulators but from law enforcement. Although credit unions recognize the importance of sharing critical information with law enforcement, some report they have received unreasonably broad subpoenas asking for all information and correspondence related to any members in a certain type of business. The threat of over-broad investigatory demands makes credit unions hesitant to provide services to members that are targeted as higher risk.

Credit unions can also be impacted by others making the decision to de-risk. At UNFCU, some of our members have international ties and some are located abroad, as a result we are presented with a unique set of risks for which we have learned to adapt.

We have found that some of UNFCU's long-standing vendors have reevaluated their relationships with UNFCU even de-risked by ending the relationship due to the fact that we serve some higher-risk members. This loss of vendors has led to a significant disruption of services and increased costs to our members. Our unique membership coupled with our vendor relationships gives UNFCU a strong understanding of the challenges from both sides of the de-risking issue.

Credit unions continue to work with FinCEN (Financial Crimes Enforcement Network) and other regulators to develop ways to provide services to higher-risk members without incurring compliance burdens and costs that are so onerous that de-risking becomes the only option.

Some ideas for improvement include first, creating a safe harbor for the financial institution providing services to high-risk accounts if they meet certain requirements in scrutiny of those accounts.

Second, ensuring the risk-based review requirements for financial institutions are understood by examiners.

And third, not making the financial institution the de facto regulator of business. While it may make sense for the institution to verify registration licensing, they should not be forced to verify levels of compliance by the business.

NAFCU also supports legislative proposals to address these issues. I outlined these in greater detail in my written statement but they include H.R. 6068, the Counter Terrorism and Illicit Finance Act which takes important steps to update and modernize the BSA/AML regime; H.R. 4545, the Financial Institutions Examination Fairness Reform Act, enacting this legislation would provide relief for financial institutions from perceived pressures from examiners; and finally H.R. 2706, the Financial Institution Customer Protection Act of 2017 that would ensure "Operation Choke Point" policies will not be used by regulators to prevent the provision of financial services to a member.

An additional area where relief is needed is the Bureau's rule on international remittances. The rule has driven a number of credit unions out of the remittance business as the cost of compliance and risks associated with it are too great. We believe that the Bureau should use its exemption authority under Section 1022 of Dodd-Frank to provide relief to credit unions on the issue.

In conclusion, NAFCU and its member credit unions recognize the importance of the BSA regime as well as the importance of regulator and law enforcement scrutiny of riskier businesses. Given UNFCU's field of membership, we serve as an example that it can be done, nonetheless heavy compliance costs, burdens, and pressures from regulators and law enforcement when dealing with high-risk members and businesses can lead many to de-risk and stop providing services to them.

Congress can help by working with financial regulators and law enforcement to alleviate these burdens and pressures. NAFCU stands ready to work with you in this regard.

Thank you for the opportunity to appear before you today. I welcome any questions you may have.

[The prepared statement of Mr. Lewis can be found on page 103 of the Appendix.]



Chairman LUETKEMEYER. Thank you, Mr. Lewis.  
Ms. Yearwood you are recognized for 5 minutes.

#### STATEMENT OF SALLY YEARWOOD

Ms. YEARWOOD. Chairman Luetkemeyer, Ranking Member Clay, and Members of the subcommittee, thank you for the opportunity to appear before you today. As one of the most insidious threats to the Caribbean's economic sustainability, de-risking is destabilizing economies, threatening trade, and creating security concerns and it requires constructive solutions. I would like to begin with some examples.

In 2015, on instruction from their U.S. correspondent banks, the two banks in the Cayman Islands that supported money transfer business, severed those relationships and the MTBs (money transfer businesses), which provide critical remittance services were forced to shut down. This led to moving cash in planes in order to make sure that the affected population had access to finance. Today only one MTB remains open.

Tourism is one of the Caribbean's most important industries and generates significant demand for U.S. goods and services. About 4 years ago, a leading hotelier told me that they had received a letter from their longtime U.S. bank, it essentially said "as of today we are no longer your bank." There was no valid explanation and no opportunity to address concerns. I spoke to that hotelier last week in preparation for this hearing to see how they had resolved the issue and was told that finding a new U.S. bank was extremely difficult and that they still feel that the situation is precarious. They did not want me to use their name, the hotel name, the name of the U.S. bank that they are now using, or disclose the country or countries where they operate.

This last point underscores why getting a grip on the impact of de-risking can be so difficult. A legitimate business has lost its U.S. banking relationships regardless of whether or not there is any real risk present, has the stain of de-risking on them so they keep it quiet and try to replace the lost relationship. Bottom line it is like Fight Club, the first rule of being de-risked is, you don't talk about being de-risked.

The toll has been highest on small- and medium-sized business where the costs of banking are becoming prohibitive. We have seen a rise in cash in informal economies in some jurisdictions and the operation of parallel foreign exchange markets. Even for long-established businesses banking has become burdensome. One U.S. company that operates in the Caribbean reports that a basic process like opening a new account that used to take 10 days or so, now can take up to 60 days and require 10 times more paperwork.

The Caribbean Association of Banks reports that nine members have no U.S. correspondent banks but have been on-boarded by third parties to manage these banking services and 17 members have only one U.S. correspondent. At the same time, they report a 39-percent year-on-year increase in correspondent banking fees between 2014 and 2017, and the cost of compliance has increased approximately 66 percent.

As relationships are lost with U.S. banks, they are being sought in Asia and the Middle East and if the United States doesn't work

to address the challenges, countries may have no option but to build new relationships and prioritize trade with other countries.

While de-risking is a motivation for the loss of banking relationships, the reality is that profitability plays a significant role as well. These are small economies in a global system and weighing perceived risk with profitability does not always work in the Caribbean's favor, even though the region has been working diligently to improve its risk profile.

It is important to stress that no one is advocating for a removal of the rules. Today's world requires that we build systems that have the capacity to recognize and eliminate threats. But this should not be done in a way that forces legitimate actors out of the system and there are a number of ways to change the narrative.

First, the U.S. Department of Treasury provides important assistance to the region. Resources could be made available to allow the Department to deepen its engagement there. Another idea related to Treasury is if larger banks are not going into the market because of the profit ratio, is there a scenario wherein community and minority banks are encouraged to serve the Caribbean using the platforms within large banks, with the large banks who make their platforms available receiving credit under the Community Reinvestment Act?

Second, innovation has the capacity to level the playing field. This is happening in the Caribbean where we have seen the emergence of technology companies that are working to remove financial friction-points across the region. I also believe that some consideration should be given to the issue of proportionality, fines can reach billions of dollars. Taken in context, Belize, which has been particularly affected by de-risking, had a GDP of just under 1.8 billion in 2016 along with 1.3 billion of external debt. If the application of the rules is weighted against small economies and their inherent vulnerabilities, how do we keep them viable?

In conclusion, taken as a group, the countries of the Caribbean and Central America are the fifth largest buyer of United States non-oil exports and the U.S. consistently records a trade surplus. If access to banking is removed or becomes more costly and difficult, it is likely that this healthy relationship will begin to be eroded.

Second, the countries of the Caribbean and Central America are the United States' third border. When the countries of the region experience instability, mass-migration is one risk, and in the absence of the U.S. actively working to help the region, the door is open to other partners who may be antithetical to the United States' security interests.

CCAA is grateful that this subcommittee has provided this platform. Thank you, Mr. Chairman for the opportunity.

[The prepared statement of Ms. Yearwood can be found on page 114 of the Appendix.]

Chairman LUTKEMEYER. Thank you, Ms. Yearwood.

I appreciate everybody's comments.

And with that we will begin the question part of our discussion today. And I will begin with my questions.

Mr. Clements, you and all the witnesses today have described concerns about the problems of de-risking across the board with re-

gards to how law enforcement and regulatory officials have come down on the people in the financial services industry.

Is law enforcement aware that they are deterring actual profitable, well-intentioned business and if they are do they have some ideas on how to fix the problem so they don't deter normal activity or are they content with driving everybody out of the business altogether?

Mr. CLEMENTS. In the two reports, we were not talking to law enforcement so I can't speak to the effect of whether law enforcement is aware of it. I think you bring up a relevant issue. In many instances it is not people telling, instructing banks, for example, to drop a customer, it is simply the effect of working through the examiners saying, this is a high-risk customer, and the next thing you know, it involves additional staff and additional resources; there is the risk of large fines that we have heard about and those things create an incentive for the bank to essentially drop service rather than have to deal with that potential risk.

Chairman LUETKEMEYER. Well it is very concerning because it is a manifestation, a morphing if you will of "Operation Choke Point" into other areas here from the standpoint of trying to intimidate the banks and then discontinuing financial services with customers who are legitimate customers or did a good job.

You know, Mr. Clements, I believe you were the one that indicated and had some nice charts in your testimony that showed the counties along the border between the United States and Mexico are being dramatically impacted, where they are closing branches so they can't do any business so they can de-risk themselves of their problem. I guess my question is, have you seen the next county above them, are they starting to de-risk as well or are they starting to close financial service because, I would assume, that if you close the branch off next to the border, that people will start going to the next county over, is that happening as well, or starting to happen now?

Mr. CLEMENTS. Our experience was just with the counties on the southwest border, it was certainly the case that one option that consumers have if they have lost their branch in that community is to go one community over and have to travel to that branch.

The other options they have are mobile banking.

Chairman LUETKEMEYER. Mr. Lewis, you are a credit union, did you see that happening, you see them closing on the border and then moving to the next county over, to where you are starting to get some pressure to be able to close those next?

Mr. LEWIS. We, UNFCU are not seeing that, as we are not located on a border State. We know that there are credit unions that are under pressure and have had some issues with it. Certainly, I could get back to you and provide a written response to that in more detail if you like.

Chairman LUETKEMEYER. Thank you.

I have another question here with regards to, there was an article from Reuters back on May 8, 2017, the headline is, "Chinese banks payment networks surge as Western lenders cut ties," and there was a study to show this and it was, I quoted the numbers in my opening statement here and the last part of this says, "the U.S. dollar dominates world trade but there is a trend toward a de-

cline in the use of U.S. dollar and an increase in the use of the renminbi," which is the Chinese dollar if you will. Have you seen this going on, any of you, where we have seen that there is a risk to the U.S. dollar being the reserve currency, we are starting to trade in other currencies versus the dollar?

Mr. Clements, you have seen evidence of that?

Mr. CLEMENTS. We have no evidence of that.

Chairman LUETKEMEYER. Ms. Eckert?

I know that you deal with a lot of charities around the world. It is terrible that even they are being hurt by this. I mean who wants to launder money through a charity but that's the ultimate slap of whatever, but can you comment on this?

Ms. ECKERT. On the question of reverting to alternative currencies, we did not see that—

Chairman LUETKEMEYER. OK.

Ms. ECKERT. But I would say that in terms of the law, the first point that you raised on law enforcement, I think it is a very interesting comment because law enforcement actually has been extremely concerned about the loss of traceability and transparency, that as these NPOs are de-risked they will either use cash, they will use MSBs, they will use alternative means.

Chairman LUETKEMEYER. OK. Ms. Haddad, I would like for you to comment and Ms. Yearwood as well on this question, have you seen any problems with this or there are concerns?

Ms. HADDAD. I haven't seen it directly but I have heard from people particularly in Africa, from banks there that when those banks were de-risked that some Chinese banks picked up the correspondent relationships that were previously held by U.S. correspondents.

Chairman LUETKEMEYER. Yes, the relationships, they are picking them up left and right like leaves on the—on the ground here.

Ms. Yearwood, have you seen anything like that with the Caribbean banks that you are dealing with?

Ms. YEARWOOD. I don't have any evidence of Caribbean banks getting Chinese accounts; however, what I have been told is that some Caribbean banks have tried to get Chinese accounts but not being able to get them because of the ongoing relationship to the U.S. dollar.

Chairman LUETKEMEYER. OK. Thank you very much. My time is up.

With that we go the Ranking Member, Mr. Clay.

Mr. CLAY. Thank you so much, Mr. Chairman. I thank the panel of witnesses for being here.

Let me start with Ms. Yearwood or Ms. Eckert or both of you, what would give financial institutions more comfort in serving remittance service providers especially those serving fragile nations, can you help us with that, whoever wants to go, Ms. Yearwood?

Ms. YEARWOOD. Thank you, Ranking Member Clay.

In my testimony I pointed to some of the things in terms of the assistance from the Treasury Department that could help give a certain amount of comfort to the people who are providing services in the region. That being said, the remittance side of the coin, I actually think Gabrielle Haddad may have some input because I think transparency and the ability to have traceability of where the

money is going and coming from is key especially when you are moving very small amounts of money so—

Mr. CLAY. Right.

Ms. YEARWOOD. I will defer to Ms. Eckert and then Gabrielle may have something to add.

Mr. CLAY. Go right ahead.

Ms. ECKERT. Thank you, Mr. Clay.

I think that what banks are asking for as they relate to NPOs is they are asking for some clarity about regulatory expectations, what is expected of them and, in fact, to the point of the interviews that I conducted, I had banks who say that they can manage risk, that is what their business is; however, what they can't deal with, there is regulator-risk and that is examiners second-guessing them all the time in terms of what their assessments are under a risk-based approach.

The other thing that the financial institutions want is they want more information to be able to make the best-informed decision so part of the process that we are engaged in is identifying what information financial institutions need from NPOs and getting NPOs comfortable providing that to banks so they can break down some of these perceptions that exist about each other.

Mr. CLAY. Thank you.

Ms. HADDAD, anything to add?

Ms. HADDAD. I would just add that I agree that the information-sharing is a huge challenge that banks face, both from money-service businesses and from respondent banks, in order for them to actually obtain the information that they need to make assessments of their relationships, is incredibly challenging and this is resulting in huge burdens and a real lack of clarity, as Ms. Eckert mentions, around what their regulatory expectations are.

Mr. CLAY. So, it is more of the uncertainty on the part of banks that they are hesitant to go forward?

Ms. HADDAD. That is what it appears to be, yes.

Mr. CLAY. I see.

This question is for Mr. Clements and Ms. Eckert, what specific steps do you believe Congress or State governments can take to address the adverse consequences of de-risking remittance service providers?

Mr. CLEMENTS. We have a variety of recommendations to the Federal agencies in terms of Treasury and the banking regulators to conduct retrospective reviews, actually looking at this issue of de-risking. The last round they simply looked at the currency transaction reports and the SAR filings but didn't get into the underlying cause of what is causing a bank to de-risk.

The second thing we have asked Treasury to look on this issue of de-risking, is remittances, the movement then of funds out of the banking system to non-banking channels, how does that affect Treasury's ability to actually monitor criminal activity. Those are a couple of things we have looked at. We have also recommended in the past, efforts among the bank regulators to reduce the burdens associated with these activities.

Mr. CLAY. I see.

Ms. Eckert, anything to add?

Ms. ECKERT. Yes. I think first and foremost again is some clarity from the regulators about what is expected and here in particular the bank examination manual, the standard changed for NPOs, in June 2016 yet there is nothing reflected other than statements by officials which are helpful but the bank has nothing to rely on in terms of how they assess risk associated with NPOs.

Currently it is an outdated assessment but banks have nothing to hold on to. if you will. and to help them make the appropriate risk assessment, the clarity, the regulatory guidance; I think another thing is to recognize the importance of humanitarian assistance—

Mr. CLAY. Yes.

Ms. ECKERT. Emphasizing that humanitarian and development assistance are important U.S. objectives, they are important for foreign policy, they are important for countering violent extremism and promoting the kind of values in certain of these higher-risk areas to rely on U.S. support.

And the other is to consider incentives, what can we do that will actually encourage banks to take the additional step to bank NPOs.

Mr. CLAY. And I see the Chairman won't let me go over my 5 minutes so I yield back.

Thank you for your response.

Chairman LUETKEMEYER. The gentleman yields back.

In fact, he went over 5 minutes significantly but that is OK, we are not counting today, are we.

With that we go to the Vice Chairman of the committee, Mr. Rothfus from Pennsylvania, you are recognized for 5 minutes.

Mr. ROTHFUS. Thank you, Mr. Chairman.

Ms. Yearwood, as you know, many poor and unstable countries rely heavily on the flow of remittances from the United States. Haiti for instance received \$1.3 billion in remittances in 2015 and its GDP is only about 8 billion. What are the potential impacts of a loss of remittances due to regulatory pressures on U.S. institutions for countries like Haiti, Somalia, and Nepal?

Ms. YEARWOOD. I think it is impossible to overstate how important remittances are to Haiti. I don't have the precise numbers on me but it is a significant portion of their GDP that is through remittances.

Going back to one of the statements earlier, what you will begin to see is not just a drop in remittances but an increase in money moving through unofficial channels, money that cannot be regulated so it puts pressure on the system, it puts pressure on securing the network and of course there are questions whether the money will get to the people that it is supposed to get to, will the money be diverted on the way, and will it get to people that it is definitely not supposed to get to.

I spent 10 years in Haiti and so I know first-hand that remittances are a significant part of what drives the economy. At this point, if it were to go away I think there would have to be serious consideration about how the U.S. engage Haiti in other ways to improve trade and other areas that aren't necessarily subject to this hearing but the remittance channels right now need to be kept open and alive.

And I am sure that Haiti's banking system is very much under stress because of this issue. I believe they have maybe one, maybe two U.S. correspondent banks right now and so if it remains fragile it could go south.

Mr. ROTHFUS. With respect to the risks of going to unofficial channels and maybe remittances not being made at all, among the risks there would be any security or political stability risks?

Ms. YEARWOOD. Oh, absolutely.

Mr. ROTHFUS. In what sense?

Ms. YEARWOOD. Again if—remittances make up such a large portion of the GDP, I wish I had brought the number but I will get that to you, they make up such a significant portion of the GDP. We are talking about a country that has high unemployment, low education, if people aren't able to pay for school fees, for school books, for health, for food, political stability is absolutely threatened and of course that has implications as we saw back in the 1990's on migration.

Mr. ROTHFUS. And in 2015 there was a paper from Oxfam, the Oxfam Global Center on Cooperative Security suggested that de-risking practices will likely result in the further isolation of vulnerable communities particularly women from the financial sector and may have wide-ranging humanitarian, economic, and security implications. Would you agree with that, Ms. Yearwood?

Ms. YEARWOOD. A hundred percent.

Mr. ROTHFUS. Let us see, yes, there we go, Ms. Haddad, the GAO (Government Accountability Office) found that several money transmitters including all of the Somali money transmitters reported that they were using non-banking channels to transfer funds, in some cases the money transmitter was forced to conduct operations in cash. What are some of the risks associated with pushing—activities out of the formal channels.

Ms. HADDAD. I would say that there are a number of risks with that happening because as it goes outside of the channels you can't monitor it anymore, you don't know where the money is flowing, you don't know who is transacting business—

Mr. ROTHFUS. But do you believe that the regulators would have appropriately weighed the risks of this activity leaving regulated markets?

Ms. HADDAD. Do you believe that they have?

Mr. ROTHFUS. Would you believe that the regulators have weighed those risks of pushing remittances out—

Ms. HADDAD. —I am not sure. I believe that a lot of these are unintended consequences of these regulations. I don't think that it was intentional or even—

Mr. ROTHFUS. Would they be considering that, do you think?

Ms. HADDAD. I don't know, I would hope so. I don't know.

Mr. ROTHFUS. Mr. Lewis in your testimony you expressed support for facilitating BSA/AML innovation by financial institutions, how can emerging technologies help to address the problems caused by indiscriminate de-risking?

Mr. LEWIS. Well, thank you for the question. Certainly, technology helps because much of it's about monitoring and crunching the numbers on the accounts it is tying certain transactions to other transactions, accumulating those transactions together so I

do believe technology will help and has helped and will continue to with BSA.

The one thing with technology is we want to make sure that all the technology and all the FinTech companies are regulated equally and it is a clean playing field, if you will.

Mr. ROTHFUS. I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired.

With that we go to the distinguished gentleman from Georgia, Mr. Scott, is recognized for 5 minutes.

Mr. SCOTT. Thank you very much Chairman Luetkemeyer for holding this hearing. And I also want to thank you Chairman Luetkemeyer for your leadership on the "Operation Choke Point" legislation, H.R. 2706, which we passed out the committee, got through the House. But I will remind everyone that it was Mr. Luetkemeyer and I who were working on this bill when it wasn't generating as much support and it wasn't a popular thing to talk about back then, especially for some of my Democratic friends, but we have grown with this legislation, it has passed, it is over in the Senate now and we hope that we can get it through.

But our bill gets at the fundamental purpose of what we are discussing today and that is there are real side effects that have a real impact on our economy when the regulatory pressure we apply on our financial system is too strong and our "Choke Point" legislation would prevent Federal banking agencies from ordering a bank to terminate a customer's account without a material reason and that reason could not be based solely on reputation risk.

Now Ms. Haddad, how are you? In your testimony, you provided an interesting recommendation for a way forward on how to deal with the de-risking trend we have seen lately and your recommendation caught my attention and it was, I quote, you say, "use of technology to lure AML/CFT (Combating the Financing of Terrorism) compliant costs without the fear of regulatory backlash," that is at the core of why we are here and I am the Co-chair of the FinTech Caucus here in the House and I share your enthusiasm about using innovative technologies to solve many of the problems we have in today's financial system.

And you say in your testimony that we should establish channels for regulatory approval and support of innovation. Tell me, are you envisioning a sort of sandbox approach to regulation?

Ms. HADDAD. Thank you for your question. I think that a sandbox approach is a very good one. I think that it is one that could be beneficial. We are a young FinTech company ourselves and we are in regular conversation with regulators because that is something that we have sought out on our own but getting that type of engagement is quite challenging and particularly working with banks and having them become comfortable, trying out your technology and being able to see how it benefits their business is a real challenge without some sort of safeguard in place from regulators.

Mr. SCOTT. And as you know, and I am sure as the committee knows there has to be a delicate balance between allowing innovation while also at the same time making sure our regulators stand firm on compliance and enforcement.



And so, Mr. Lewis, I would be interested to hear how you feel about the approach and recommendation that Ms Haddad is offering?

Mr. LEWIS. Thank you. I appreciate it. I think that any way technology can benefit, we should be looking at it. One of the problems we run into with technology and new technology is that technology is expensive, it is very resource-intensive. Our systems at our credit union and many credit unions are extremely complex, creating in the interfaces between the systems and the new technology, testing the new technology, demonstrating that to regulators, can be expensive and resource-intensive so we certainly are always willing to and very interested in looking at new technologies.

We use technology to operate our credit union on a daily basis, some is home-grown and some was bought from vendors but it is not so easy always just to test out a technology because of the entry costs for us.

Mr. SCOTT. And tell me about that cost, you say it is very expensive but give us an idea, give us what you are talking about, why do you say that?

Mr. LEWIS. Well I can give you one example on the remittance side, when the remittance regulation came into effect, there were requirements for disclosures and we had to use outside third-party in order to create these remittances, to originate the remittances because we weren't able to do it ourselves. In order for us to create that interface with this outside third-party, UNFCU spent over \$1 million to create that single interface with this outside entity and it took about 3 months of time.

Mr. SCOTT. Well thank you.

And Ms. Haddad, do you concur with that?

Ms. HADDAD. I mean engineering costs, costs of developing technology is incredibly high—

Mr. SCOTT. Yes.

Ms. HADDAD. —and banks are trying to do this internally and they are incurring a lot of costs internally. As an external company that is trying to work with banks, I understand the costs, the costs are significant and it is helpful to be able to work with third-party companies to reduce the cost that the banks themselves have to face in leveraging these technologies.

Mr. SCOTT. Well thank you both.

Thank you, Mr. Chairman.

Chairman LUETKEMEYER. The gentleman's time has expired.

I too want to thank Mr. Scott though for his leadership and tenacity working with us on "Operation Choke Point." We were the lone voices in the wilderness for a long time and now we can see the effects, even at the international level, of some of these policies and actions that we have taken, so I thank him again.

With that we go to the gentleman from Colorado, the distinguished gentleman, Mr. Tipton is recognized for 5 minutes.

Mr. TIPTON. Thank you, Mr. Chairman.

I thank the panel for taking the time to be here.

Mr. Lewis, if I could start with you, we would have had a comment from Ms. Yearwood, I think saying some of the compliance costs had gone up 66 percent and you just cited a billion dollars of investment that had to be made, some of that seems to be cou-

pled back with what Ms. Eckert was talking about when she had made the comment that banks have nothing to hold on to in terms of having some real guidance.

Does that feed on itself not having some certainty in terms of what you are going to have to be dealing with in terms of de-risking, what you need to be looking for? I found it a little concerning when you were citing that you will have some of the law enforcement agencies that will come in and ask for a broad swath rather than an individual account, that they would like to be able to look into, which speaks to the chairman and Mr. Scott's words in regards to "Operation Choke Point" so are those issues, when we mold them together, is that creating real complexity for you?

And you had cited a few bills in your testimony that we are working on out of this committee, would you expand on how those might be helpful as well?

Mr. LEWIS. Well first, thank you very much for the question. I would say that, yes, those things in combination provide complexity for us. If they comply, it is cost, it is resources, and it is the uncertainty. In essence, we are talking about risk here and risk is uncertainty and for an institution like ourselves, if we have some certainty then we are able to evaluate the risk and mitigate against that risk; it is the uncertainty that causes the problems with us and in our industry.

So, anything that the regulators, Congress, the Bureau, can provide some certainty on is beneficial.

I think some of the bills that we were talking about here certainly—relief on 6068 which is the BSA/AML bill, that will certainly help us, maybe not with uncertainty but it will reduce some of the burdens as some of the caps will be raised on what we would need to report; 4545, Financial Institutions Examination Fairness, again this would provide institutions with the ability to challenge or to go to the next level if they have problems with the regulator or examiner.

So, I think and certainly "Operation Choke Point" would help because theoretically that would reduce the regulatory burden on credit unions and financial institutions.

Mr. TIPTON. Great. Thank you for that. You might want to speak to this as well but I would like to be able to talk to Mr. Clements a little bit in regards to some of your testimony.

I happen to live in an area southwest Colorado, we have a lot of high-intensity drug-trafficking designation areas, five counties, southwest Colorado, are these areas more prone probably to be suspect for de-risking by banks as we move off of the borders that you had noted in some of your charts and start to move up in States as far north as Colorado?

Mr. CLEMENTS. We conducted an econometric model as part of our report and in that case it was nationwide so we weren't just limited to the southwest border States. To your point, some of the variables we did look at were the high-intensity drug-trafficking areas (HIDTA), and high-intensity financial crimes areas. In both those types of locations if the county was designated, it had a greater likelihood of losing a branch the following year, so those are certainly factors in the declining number of branches in communities not just along the southwest border but nationwide.

Mr. TIPTON. Good. Do you have some examples of some misplaced assumptions of high risk because of the HIDTA designation for some businesses?

Mr. CLEMENTS. We looked at a variety of classes of customers that stakeholders had told us were at greater risk of money laundering, those would be cash-intensive small businesses, money services business, and also domestic businesses that have a lot of cross-border transactions. Those would be the ones that they told us would be related to money laundering, not exactly a particular business. You could have a business that is completely legitimate operating in that space but money launderers, their transactions tend to mirror the type of transactions that you would see businesses in those spaces engaged in.

Mr. TIPTON. And so probably the extension would be natural, and Mr. Lewis you might want to speak to some of this as well, do the banks de-risk because of that HIDTA designation simply for the fear that they are going to be out of compliance and have a challenge with that?

Mr. LEWIS. Well certainly, we haven't experienced that directly but I know many of our credit unions have, and what it comes down to is it comes down to the intensity of scrutiny both from the regulator and law enforcement, so it may not be a directive to de-risk but in essence it is an indirect effect of the intense scrutiny either by a regulator and/or by law enforcement with regards to these businesses.

Mr. TIPTON. Right. Hey my time is expired. Mr. Chairman I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired.

With that we go to the gentleman from Georgia, Mr. Loudermilk, you are recognized for 5 minutes.

Mr. LOUDERMILK. Well thank you Mr. Chairman.

And thank everyone on the panel for being here.

Ms. Haddad in your testimony you talked about how de-risking reduces transparency by redirecting money to unregulated channels, can you elaborate a little bit on how that happens?

Ms. HADDAD. Sure, I would like to highlight something that happened actually just last month with a bank in Argentina, this Bank chose to drop SWIFT in favor of a strategic partnership with BIDEX, which is an unregulated crypto-exchange firm and they are now using this crypto-exchange firm to settle their international payments and the CEO noted for the reason cost, and said that the cost of having an intermediary was too high.

And I bring up that example because we speak a lot about other unregulated industries like Hawala and unregulated money service businesses as well as movement of large amounts of cash cross-border, which are things that happen but I wanted to highlight that because I think that this is critical today with the change in the payment landscape, with the rise of crypto exchanges, with the rise of alternative payments that this is what is happening now that these alternative providers are now gaining traction and banks are no longer a part of the system.

Mr. LOUDERMILK. So, I know that we have been dealing a lot with the cryptocurrencies here in the U.S. with the Blockchain technology which I think when you divest the cryptocurrency from

Blockchain, Blockchain's an interesting technology but it also gives some challenges to law enforcement so what you are saying is because of de-risking, we are forcing some businesses into these somewhat underground networks that make it harder for us to track and trace.

Ms. HADDAD. Exactly there are no alternatives for the payments to flow or for money to flow if they can't access either a remittance firm—

Mr. TIPTON. Yes.

Ms. HADDAD. A regulated remittance firm or a bank and that is why we are seeing the rise of these alternative systems.

Mr. LOUDERMILK. So, we are really being counterproductive, well through this de-risking is creating more risk.

Ms. HADDAD. It is possible. It is possible. I believe that there actually have been some studies that have shown that that when the de-risking has occurred that money laundering has increased, I don't have those exact numbers, I could get them for you but there have been some instances that I have read in the past where that has happened.

Mr. LOUDERMILK. OK. Thank you. That was a very interesting antidote.

Mr. Lewis, I want to talk a little bit about the Suspicious Activity Reports (SARs), can those contribute to the problem of de-risking because the SARs are such a compliance burden especially on smaller institutions.

Mr. LEWIS. Yes. Thank you for the question. Certainly SARs BSA/AML requirements create a lot of constraints for smaller finance institutions and even for institutions like ourselves. People talk about the volume of SARs, which is certainly something that we need to look at but also, what we have to understand is that behind each SAR there is a tremendous amount of research and investigation and decisioning that goes into it.

We take SAR filing very seriously and while we are told by the regulators, "don't file too many SARs, we don't want defensive SARs," we are also told by the regulators, "make sure you file the right SARs," and so for us to strike that balance to the institution, it takes a lot of research, a lot of investigation to do it.

We certainly support 6068 by raising the limit of the SARs, modernizing BSA, as that in and of itself would eliminate the need to file at least some SARs which would provide some relief for us and certainly for some smaller financial institutions.

Mr. LOUDERMILK. Well besides raising that limit for the SARs, is there anything else that you would recommend that we can do to reduce that burden?

Mr. LEWIS. Well certainly more guidance and certainty would help out as well. A lot of the consternation we have is should we file the SAR, shouldn't we file the SAR, under what circumstance should we, under what circumstances we couldn't.

Now we do receive some guidance from the regulators but even more guidance or maybe some possible safe harbor, don't know how that would work as I sit here but something that would give us an opportunity for more certainty with what we are doing.

Mr. LOUDERMILK. OK. Thank you.

Mr. Chairman, I yield back.

Chairman LUETKEMEYER. The gentleman yields back.

With that we go to the gentleman from Texas, Mr. Williams, is recognized for 5 minutes.

Mr. WILLIAMS. Thank you, Mr. Chairman.

Risk management is one of the most important functions that a financial institution performs. As a business owner myself I can relate to the fact that compliance challenges especially the excessive growth of Federal regulations over the past 10 years, it has been hard. De-risking forces an institution to perform the cost-benefit analysis of doing business with a customer. "Operation Choke Point" is one of those many examples of Executive-overreach from the previous Administration.

While this Administration has taken deliberate action to curb efforts like "Operation Choke Point," we must be vigilant for future occurrences and this isn't theoretical, it is reality.

I know firsthand how this occurs because I have experienced "Operation Choke Point." Now while I understand the importance of risk management, it is important not to view whole industries as potentially high-risk groups, apply a single standard to industries in different States with different business owners and values is inconsistent in my belief.

So, Mr. Lewis, first question, how would you categorize the working relationship between State banking supervisors, Federal regulators, and industry stakeholders when it comes to discussion of de-risking.

Mr. LEWIS. Thank you for the question. From our experience I think there is some unevenness that echoes on. We are a federally chartered credit union so we don't have much direct contact with the State regulators so NCUA is our examiner and regulator. We do, however, through law enforcement, we will receive subpoenas and we will receive others and a lot of times there's not coordination between those various areas of law enforcement with regards to the subpoenas.

Mr. WILLIAMS. OK. Next question also Mr. Lewis. I introduced H.R. 3626, the Bank Service Company Examination Coordination Act, this Bill would enhance State and Federal regulators' ability to coordinate examinations and share information on bank's technology vendors in an effective and efficient manner.

So, my question would be, can you touch on the benefits to authorizing State regulators to examine third-party TSPs (technology service providers) and how that could avoid duplicative examinations and reduce regulatory burden on an institution?

Mr. LEWIS. Yes. Again, thank you for the question. We again, we are a federally chartered credit union; I personally don't have a lot of experience with State credit unions or regulators. What I can say is we welcome the opportunity to follow up with you in writing with that question, also we can provide a good and thorough answer.

Mr. WILLIAMS. OK, thanks.

Mr. Clements, the Justice Department recently announced the end of "Operation Choke Point," are you aware of any account termination notices since that announcement?

Mr. CLEMENTS. Not aware of any. We haven't conducted work on that point.

Mr. WILLIAMS. OK, thank you.

I might ask if anybody else—so the question I talked to Mr. Lewis—again I repeat if anybody wants to answer it, can you touch on the benefits to authorizing State regulators to examine third-party TSPs and how that could avoid duplicative examinations and reduce regulatory burden on an institution, anybody would like to answer that?

Yes ma'am?

Ms. ECKERT. Congressman, I would just note that the question of State regulators has become an important issue because there are growing fines. For example, the New York, Department of Financial Services has had significant fines on numerous banks and I think that because they are looking at it from a different perspective it has become a very significant issue in compatibility perhaps of how some of the regulators are actually looking at it.

The other question is examiners and the disconnect either at the State level but in particular at the Federal level, the disconnect between what policy is and what is going on at the examination level; the examiners are sitting with the banks, day-in and day-out. I had a situation where one financial institution said their examiner asked them, "do you know your customers' customer?" And when the Bank said, "well according to the 2006 guidance we don't need to know our customers' customer," the examiner didn't even know that there was August 2016 guidance.

So, I think that there's an important you know, compounding effect of State regulations on top of the Federal ones.

Mr. WILLIAMS. OK, thank you.

In my remaining time I might ask all of you, getting back to "Operation Choke Point," do any of you know, that if account termination notices have been sent out or anything or how that is going to happen, "Choke Point"?

OK, very good.

I yield the rest of my time back, Mr. Chairman.

Chairman LUETKEMEYER. The gentleman's time is yielded back.

With that we go to the gentleman from Tennessee, Mr. Kustoff, is recognized for 5 minutes.

Mr. KUSTOFF. Thank you, Mr. Chairman.

Thanks to the witnesses for appearing this afternoon.

Mr. Lewis, if I could, I could go a little bit broad and talk about, going back to the 2008 financial crisis and the enactment of Dodd-Frank, we have seen Financial Service regulators expand their powers significantly, I think we can all agree to that.

With the heightened regulatory requirements, coupled with the prospect of financial entities receiving fines for potential violations, we have seen the significant decrease of products that many community banks and credit unions now offer. I think a lot of times you see consumers look elsewhere to find where they can have their services met, their needs met. Some leave the financial system entirely, if I could ask two questions.

One is can you discuss the consequences to driving those customers out of the financial system, that is the first question?

And then the second question is, toward that end, where do those people typically go when they no longer have access to financial products that a credit union or a community bank would offer?

Mr. LEWIS. Well thank you very much for the question.

I would like to add that, in addition to my role with UNFCU and with NAFCU, I also recently was the Vice Chairman of a community development credit union in New York with less than \$1 million in assets so I have experience in both the large side and the small side.

And with that community development credit union, unbanked and underbanked is a major problem in the community for various reasons, so if these folks leave the standard banking channels, they lose the opportunity for credit, they lose the opportunity for credit reporting, they end up in areas where it could be check-cashers or places where they are paying a huge amount of fees in order for them to be able to cash their checks; they don't have access to standard insurance products.

So, any time anyone's pushed out of the traditional banking industry they are generally not going to a better place, certainly we know that from the credit union's perspective; credit unions as financial cooperatives owned by the members, the reason for being is to serve the members so we are always looking to serve those in our field of membership and we will continue to do so, but we think that anyone who leaves the system is not going to a better place.

Mr. KUSTOFF. Thank you very much for your answer.

Mr. Clements, if I could, we have talked about the problems along the southwest border and in February of this year, a report was issued by the GAO that examined de-risking along the southwest border. The three factors I think you have identified are unique to account closings at financial institutions in the region. Specifically, I think you noted that these accounts are generally cash-heavy, they involve foreign account holders, and those transactions cross or transcend country boundaries.

Can you explain why these findings are unique to the southwest border and what are the characteristics that have been important drivers if you will behind the branch closures in the region?

Mr. CLEMENTS. Correct. Those were the factors we had cited, one: The large number of cash transactions. Just to give you an indication, the currency transactions, 30 percent more currency transaction reports filed by banks in the southwest border region. Compared to comparable counties. There is the issue of a lack of transparency if you have a lot of cash transactions.

Then also the issue of the cross-border transactions. The concern there is that a transaction crossing the border can look very much like money-laundering even if it is a completely legitimate transaction.

We spoke with a farmer in Nogales, Arizona, and she had operations in Arizona and Mexico and she needed to move moneys, wire moneys from her Mexican operation up to a U.S. bank and after a while the bank told her, this is too much risk for us having these transactions going back and forth.

And then again last the issue of the foreign account holders is just a problem with being able to identify that customer and to meet the customer identification program requirements under BSA/AML.

Mr. KUSTOFF. Thank you very much.

And I yield back the balance of my time.

Chairman LUTKEMEYER. The gentleman yield's back.

With that we go to the gentlelady from New York, Ms. Tenney, is recognized for 5 minutes.

Ms. TENNEY. Thank you, Mr. Chairman.

And thank you to the panel for appearing today. I really appreciate you being here and obviously de-risking has become somewhat notorious especially in a community like mine but under the Obama Administration, "Operation Choke Point" attempted to cut-off financing for ammunition and gun manufacturers like Remington Arms, which was founded in my district over 200 years ago and a new industry, a new competitor in that market called Oriskany Arms and so we know, we have experienced some of that in our own area.

But I would like to look at a couple of other things, angles that de-risking and the links to the closure of a lot of branches, small businesses or small banks and community banks and also credit unions in my region which really dominate where I live, in my district, and the implication on our very large immigrant and refugee populations, many of these people would like to send their money back to their home countries and do it in a safe way but under de-risking of course, they have been pulled from a reliable and a safe way to send that money over.

One of the issues is by pulling that out and there was a study and the Government Accountability Office came up with some numbers that the banks are now just terminating those accounts and now they are not able to do this so they are forced to go into other means.

I was wondering if you could comment, and I would just ask everyone across the board, generally on what is being done or what we can do on our side to try to deal with this de-risking phenomenon and how we help people who are in that situation? And maybe we could just go right through from Mr. Clements on down, and I want to just save 1-minute left because I have a question for Ms. Eckert at the end, having to do with New York State.

Mr. CLEMENTS. We have a variety of recommendations to the agencies to address de-risking including FinCEN and the banking regulators—

Ms. TENNEY. Yes.

Mr. CLEMENTS. Conducting retrospective reviews to really get at what are the underlying causes of de-risking rather than simply focusing on more superficial level of concerns.

And then second, getting to your point of the remittances, we have asked Treasury to look at if de-risking is causing banks to cancel these accounts, therefore the remitters have to move to non-banking channels, what is the implication of that for security, what is the implication for consumers being—

Ms. TENNEY. Yes.

Mr. CLEMENTS. Able to get the types of services they need.

Ms. TENNEY. And as we go down the line, let me just also add that I am in an area where we don't have as much connectivity in terms of broadband, in terms of being able to get on the Internet and we have a lot of a refugee population and a lot of our seniors don't have access either so maybe you could address that while we



are saying how do we provide this service back to a bank where they are not going to be subjected to, in this case obviously from New York, excessive regulation coming on the New York side?

Mr. CLEMENTS. The concern with—

Ms. TENNEY. Yes.

Mr. CLEMENTS. If a bank branch closes that obviously limits the number of options for the consumer. I was going to say one of the options would be mobile banking or online banking but that is not an option and—

Ms. TENNEY. Not always, yes.

Mr. CLEMENTS. A senior person is either forced to find another bank if there is one in that area. Or drive 45 minutes to 1 hour, one way to get to another institution.

Ms. TENNEY. Thank you.

Ms. ECKERT and you know, while you are at it, quickly just comment on the New York State regulatory regime in this space if you could, please? You alluded to it earlier so it got my interest on that.

Ms. ECKERT. I think it is important, so what happens when these communities are de-risked, in the case of nonprofits and charities, their mission is to provide humanitarian development assistance so they don't really have the option of saying, well we are not going to do it and only I think 3 percent of the cases, what we surveyed, did they cancel the program.

What they have done is to find the other alternatives around, which is carrying cash, it is using unregulated money remitters. And all of those things come at a cost for charities in particular working in conflict zones, those come at a personal cost in terms of safety, carrying large bags of cash is enormously, inherently, dangerous for their staff and for their beneficiaries but more than that it drives these things underground which means that they are not traceable and that they are not transparent to regulators.

The charities prefer to use the banking system, in fact some of them aren't even comfortable with money service businesses as much but there is no alternative.

Ms. TENNEY. Do you find that the New York State government has been effectively making it more difficult for a lot of these people to have access or a lot of the charities that you are referring to not-for-profits having access to a way to be able to avoid having to carry around cash and to be putting themselves at risk?

Ms. ECKERT. I don't have—

Ms. TENNEY. Quickly, I am running out of time.

Ms. ECKERT. I don't have direct information with regard to the New York system but what I will tell you is that the personal liability now the individual compliance officers, those things all contribute to what financial institutions have to decide, which is, it is just not cost-effective for us to bank these charities.

Ms. TENNEY. Thank you very much to the panel, I am out of time, thank you.

Chairman LUETKEMEYER. The gentlelady's time has expired.

With that we go to the gentleman from Kentucky, Mr. Barr who is Chairman of our Monetary Policy Committee—

Mr. BARR. Thank you, Mr. Chairman—

Chairman LUETKEMEYER. You are recognized for 5 minutes.

Mr. BARR. Thanks for holding this important hearing.

And I wanted to start with Mr. Lewis and touch on some testimony that you offered earlier about the need to modernize SARs and these Suspicious Activity Reports under the Bank Secrecy Act and the—and your call for a greater guidance and certainty from the regulators may be a safe harbor.

What percentage of SARs would you say if you have an estimate, would actually justify further scrutiny or investigation by regulators or officials investigating genuine cases of terror-financing or money-laundering?

Mr. LEWIS. I would say on the terrorist-financing side, a very, very, very small percentage.

On the money-laundering side, I couldn't quote a percentage. I would say that there's some but many of the SARs that we file, while I think they are legitimate SARs under the guidance are probably not indicative of any sort of illegal activity, remember SARs is suspicious activity, it is not necessarily an illegal activity.

Mr. BARR. Right. And that is the difficult balance that we have to, as policymakers, we have to figure out how to strike that balance.

If we were to create a safe harbor or if the regulators were to create a safe harbor, well how would we know we are not missing something?

Mr. LEWIS. Well I think that is always the balance. We are never going to be sure we are not missing something but there's going to be a balance of the effort and what the utility of it is, is that I couldn't sit here today and chart that out for us but certainly I think it is worthy of a robust discussion and we would welcome the opportunity to discuss that further.

Mr. BARR. Thanks, and I will move on but I would invite further feedback from any of the witnesses about what a safe harbor would look like, so as to ease compliance burdens while at the same time not missing any critical information for law enforcement.

Ms. Haddad, from your testimony it sounds like you believe there is obviously a complicated set of factors that have led global banks to de-risk and stop offering some or all services in a particular region due to non-credit risk.

In your mind what is the number one reason why these banks are de-risking?

Or if there's more than one factor, you can offer that as well?

Ms. HADDAD. I do think that it is difficult to pin-point the number one because they are all interrelated so profitability concerns is related to increased costs of compliance and so all of the factors end up being related to one another.

But I do think that one of the biggest challenges is around balancing the cost of compliance with the revenue potential of a particular relationship.

Mr. BARR. And I am sure you have already touched on this but can you amplify your testimony on what role new technology and third-party providers of independent standardized assessments of respondent banks compliance with global standards might have on de-risking?

Ms. HADDAD. Sure. Today there does not exist a global benchmark. It is frankly what we are creating at Sigma Ratings and the relevance of this is that if there is a global standard and there is

one tool that is used to conduct initial due diligence that provides a baseline for correspondents to actually look at their respondent relationships, this standardization will allow them to have a starting point from which they can then do additional due diligence.

So today the way that it works is that these respondent banks have a number of correspondent banking relationships sometimes you know, 10 to 20 correspondent banking relationships and they are required to provide the same information to each of those, over and over and over again and then each of the global banks or the regional banks are then required to review all of that information individually and provide their own risk assessment.

If there is a standardized approach that provides a baseline risk assessment on all of the respondent banks or potential respondent banks, then each of those global correspondents can start from that point and then do additional due diligence on top of it. It would reduce the redundancies that are happening across the entire system and it would also allow for banks to focus their time and energy and money on real risk.

Mr. BARR. And in my time remaining, back to my question to Mr. Lewis, what would a safe harbor on SARs look like, how might this platform that you are creating limit the number of superfluous or unnecessary SARs?

Mr. LEWIS. Thank you. I think what Ms. Haddad's company has done is excellent. I think it is a great start and it is a direction and any information is good information, the question of course is how expensive the utility but certainly I think any information is good information for us to have but how much is that information going to cost us.

Chairman LUETKEMEYER. The gentleman's time—

Mr. BARR. My time has expired.

Chairman LUETKEMEYER. —has expired.

Votes have been called but we have two witnesses or two questioners yet.

So, Mr. Green from Texas is recognized for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

I thank the Ranking Member as well.

And I also thank the witnesses for being here today to discuss de-risking, which is another way of saying closing accounts, and these accounts are being closed to avoid legal liability. And by the way, there's nothing wrong with avoiding liability. I think that it is perfectly appropriate that you avoid liability if you can.

The question that I have has to do with the NGOs that are trying to be of help and that are finding themselves without the means by which they can transfer large sums of money to people who are in need of the help. That is doing good but running into obstacles that are just not appropriate sometimes.

So, my first question is to what extent does this problem exist? I have talked to at least two NGOs, there may be many more, there may be just a few but to what extent does the problem exist as it relates to NGOs, these are nongovernmental organizations?

Ms. ECKERT. Congressman, as a colleague of mine has said, we have been admiring the problem, we know that there is a problem. Two-thirds of all U.S. charities, NPOs are facing financial access difficulties and that has a very serious impact on their ability to

be able to transfer funds for humanitarian and development assistance.

Part of the problem is that it is not just closing of accounts and that is one of the reasons why going beyond de-risking, the term, we talk about financial access because in the case of nonprofit organizations, delay and denial of wire transfers are actually a very serious problem; when it takes 6 months to provide fuel for a hospital in Syria, the situation is obviated; when it takes so much time to actually get the bank to provide permission for the wire transfer, the assistance is thwarted and in that regard the utility, the technologies, that we have been talking about.

KYC Utilities can actually provide a significant path forward and that is because of the repeated requests for information, the same charity gets repeated quest—requests from the same Bank for the information. If we are able to create a utility where all of the NPO information resides, financial institutions can actually rely, go there, get all of the information about their internal compliance, their due diligence procedures, and that is a repository or KYC Utility for nonprofits is something that the World Bank and ACAMS processes is exploring.

Mr. GREEN. It is ironic that you would mention the example that you did because that is exactly what was called to my attention about the delay that it was taking, what was thought to be an inordinate amount of time, an unusual amount of time to do something that was thought to be relatively simple so but again I understand that it is happening but is it happening to a large number of entities, 10 percent, 50 percent, 20 and just a guesstimate?

Ms. ECKERT. The study that was conducted and released last year found two-thirds of all U.S. charities, NPOs, are experiencing these problems.

Mr. GREEN. Two-thirds?

Ms. ECKERT. Two-thirds and that was surprising.

Mr. GREEN. OK.

Ms. ECKERT. It was extremely surprising and I would just say with regard to the problems that are experienced, account closures represented only 6 percent, refusal to open accounts was about almost 10 percent but the transfers delayed was 37 percent of the charities that were actually surveyed so that kind of delay, fee increases, et cetera are really posing very serious problems for the provision of important humanitarian and development assistance.

Mr. GREEN. Ms. Yearwood, do you have any additional comments on this?

Ms. YEARWOOD. The only comment I would like to add is that this isn't only a problem for charities. I can cite at least one Caribbean government that could not get a bank account for their embassy here in the United States and so this doesn't only have implications for charity, it has implications for diplomacy.

Mr. GREEN. Well thank you very much.

Mr. Chairman, thank you for the time. I do have another question but I think it might go well beyond my 12 seconds, so thank you very much.

I yield back.

Chairman LUETKEMEYER. The gentleman yield's back his time.

With that we go to the gentleman from North Carolina, Mr. Pittenger is Vice Chairman of the Terrorism Financing Committee, you are recognized for 5 minutes.

Mr. PITTENGER. Thank you, Mr. Chairman.

Really appreciate each of you being here today. I know you made a great effort to do that and your knowledge is very much appreciated. I would like to just address to a greater extent, further discussion, issues related to the cumulative effects of the AML/CFT and risk management compliance on the financial service industry.

Just Mr. Lewis, if you could please, just give me some effect, impact of the account of these terminations by this de-risking?

Mr. LEWIS. Thank you very much for the question.

I think from my perspective UNFCU, we have one very, very significant example of this and we have several but that would be with regards to international remittances through Dodd-Frank and through the Bureau's ruling and rules; we had to basically change our entire remittance business. We were able to originate remittances ourselves for our members but then certain requirements came in to be with regards to disclosures.

One disclosure was all the fees that would be taken out, the problem is we don't control that transfer so if there's a transfer going to Asia it may go through a correspondent bank in Europe and then through a correspondent bank in Asia and they may take fees out of that so what we had to do is because we couldn't do that, we had to go to a third party to do that and what that ended up doing is it ended up increasing the expenses for our members because we had to go to the third party.

In addition to that, it ended up consolidating the industry because what you had was many credit unions have gotten out of the business of remittances, obviously simply can't afford the technology and they can't track it as well so you have this consolidation which increases fees and costs and then on top of that, as I was saying earlier, on our technology side in order to do that, it was a million dollars.

So that is just one small example of what we endured with regards to one specific type of regulation and I know the credit unions across the board are experiencing similar situations.

We as credit unions don't really fire customers, we don't have that luxury if you will to do that. The best we can do because we can't terminate an account without a very, very long process so the best we can do is restrict services but it is a real issue and a real problem for credit unions.

Mr. PITTENGER. Thank you, sir.

Sure, Ms. Eckert?

Ms. ECKERT. Mr. Pittenger in terms of additional monitoring compliance costs of AML/CFT regulations, some have placed it at \$4 billion annually, one bank reported that over 4,000 additional compliance staff—

Mr. PITTENGER. Yes.

Ms. ECKERT. —in 1 year were hired at a cost of a billion dollars. In 2016, the Association for Certified Anti-Money Laundering Specialists surveyed their members and found that three-fifths of the respondents cited enhanced regulatory expectations as the greatest AML compliance challenge.

So, these are real costs. No one is saying that it is solely due to that but it is among the most frequently cited causes of de-risking or financial access difficulties.

Mr. PITTINGER. Thank you.

Ms. Eckert, let me address the issues related to law enforcement and national security agencies and their ability to track financial activities and potential criminals, does de-risking make it harder for them to do that?

Ms. ECKERT. I would say absolutely, sir, because as charities and other de-risked communities have to find alternatives, they go to unregulated money remitters, they go to Hawalas, they go to places where they are not transparent or traceable and that is contrary to what our money laundering and terrorist financing regime is all about, and that is responsibility of financial institutions and others and traceability and transparency so I think that the negative implications for counter-terrorist initiatives and security overall are quite significant.

Mr. PITTINGER. Thank you very much.

Mr. Clements, I would like to ask you if you would just speak to the specifics of what impact communities face when banks as well as bank branches close up and move away due to de-risking?

Mr. CLEMENTS. There were a variety of challenges for the community. Just for the consumer angle, the consumers are going to lose that access to the service. On a broader economic scale, you are going to have less business lending which then will ultimately flow down into lower employment, lower wages would be some examples.

Mr. PITTINGER. Thank you. Can I ask another question? I don't have enough time.

Thank you.

Chairman LUETKEMEYER. The gentleman yield's back.

With that I want to thank the witnesses for being here today. I would love to follow up a little bit more here but we have to rush-off to a vote.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

With that this hearing is adjourned.

[Whereupon, at 3:39 p.m., the subcommittee was adjourned.]

# **A P P E N D I X**

June 26, 2018



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United States Government Accountability Office

Testimony  
Before the Subcommittee on Financial  
Institutions and Consumer Credit,  
Committee on Financial Services,  
House of Representatives

For Release on Delivery  
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## BANK SECRECY ACT

### Further Actions Needed to Address Domestic and International Derisking Concerns

Statement of Michael E. Clements, Director,  
Financial Markets and Community Investment



## GAO Highlights

Highlights of GAO-18-642T, a testimony before the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, House of Representatives

### Why GAO Did This Study

In recent years, some Southwest border residents and businesses reported difficulty accessing banking services, including experiencing bank account terminations and bank branch closings in the region. In addition, the World Bank and others have reported that some money transmitters have been losing access to banking services with depository institutions.

This statement is based on findings from GAO's February 2018 report on access to banking services along the Southwest border (GAO-18-263) and March 2018 report on the effects of derisking on remittance flows to fragile countries (GAO-18-313). GAO discusses (1) the extent to which banks are terminating accounts and closing branches in the Southwest border region, (2) the extent to which money transmitters serving selected fragile countries are facing banking access challenges, and (3) actions relevant U.S. agencies have taken to respond to these challenges. For those reports, GAO surveyed more than 400 banks, developed an econometric model on the drivers of branch closures, and conducted case studies on four countries to assess the effects of derisking on remittances flows.

### What GAO Recommends

GAO made five recommendations in the two reports: to Treasury and the federal banking regulators to conduct a retrospective review of BSA/AML regulations and their implementation, and to Treasury to assess shifts in remittance flows to nonbanking channels. Banking regulators agreed with the recommendations. GAO requested comments from Treasury, but none were provided.

View GAO-18-642T. For more information, contact Michael E. Clements at (202) 512-8678 or ClementsM@gao.gov.

June 26, 2018

## BANK SECRECY ACT

### Further Actions Needed to Address Domestic and International Derisking Concerns

#### What GAO Found

"Derisking" is the practice of depository institutions limiting certain services or ending their relationships with customers to, among other things, avoid perceived regulatory concerns about facilitating money laundering or other criminal activity such as financing to terrorist groups. In its February 2018 report, GAO found that money laundering risk is high in the Southwest border region because of the high volume of cash transactions, the number of cross-border transactions, and foreign account holders. According to GAO's nationally representative survey of banks, an estimated 80 percent (+/- 11) of Southwest border banks limited or did not offer accounts to customers that are considered high risk for money laundering because the customers drew heightened Bank Secrecy Act/anti-money laundering (BSA/AML) oversight—behavior that could indicate derisking. Nationally, GAO's econometric analysis suggested that counties that were urban, younger, had higher income, or had higher money laundering-related risk were more likely to lose branches.

In March 2018, GAO found that money transmitters (businesses that facilitate global money transfers) serving Haiti, Liberia, Nepal, and especially Somalia—countries it identified as fragile—all reported losing bank accounts or having restrictions placed on them during the last 10 years. As a result, 9 of the 12 money transmitters GAO interviewed, including all 4 that served Somalia, reported using channels outside the banking system (hereafter referred to as nonbanking channels), such as transporting cash to transfer funds, and that this increased their operational costs and exposure to risks. Furthermore, some banks GAO interviewed reported that they closed the accounts of money transmitters because of the high cost of due diligence actions they considered necessary to minimize the risk of fines under BSA/AML regulations. Department of the Treasury (Treasury) officials noted that despite information that some money transmitters have lost bank accounts, Treasury saw no evidence that the volume of remittances was falling or that costs of sending remittances were rising.

To address concerns about derisking, Treasury and federal banking regulators (the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation), have taken actions including issuing guidance to banks and conducting some evaluations to assess the extent to which derisking is occurring. While agencies were engaged in BSA/AML regulatory reviews, these were limited in scope and had not evaluated how regulatory concerns may influence banks to engage in derisking or to close branches. Without assessing the full range of BSA/AML factors that may be influencing banks to derisk or close branches, Treasury, the federal banking regulators, and Congress do not have the information needed to determine if BSA/AML regulations and their implementation can be made more effective or less burdensome. Moreover, in March 2018 GAO reported that Treasury could not assess the effects of money transmitters' loss of banking access on remittance flows because existing data did not allow Treasury to identify remittances transferred through banking and nonbanking channels. Nonbanking channels are generally less transparent than banking channels and thus more susceptible to the risk of money laundering and terrorism financing.

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Chairman Luetkemeyer, Ranking Member Clay, and Members of the Subcommittee:

I am pleased to be here today to discuss our recent work on derisking and how it may be affecting the availability of banking services to customers in the Southwest border region and money transmitters who transmit money to fragile countries.<sup>1</sup> Derisking is the practice of depository institutions limiting certain services or ending their relationships with customers to, among other things, avoid perceived regulatory concerns about facilitating money laundering or other criminal activity such as financing to terrorist groups.<sup>2</sup> Money laundering and terrorist financing pose threats to national security and the integrity of the financial system and the Bank Secrecy Act (BSA) is an important tool in federal law enforcement efforts to detect and deter the use of financial institutions for such criminal activity.<sup>3</sup> The BSA and its implementing regulations generally require financial institutions, including banks and money transmitters, to collect and retain various records of customer transactions, verify customers' identities, maintain anti-money laundering (AML) programs, and report suspicious transactions.

However, in recent years, some Southwest border residents and businesses reported difficulty accessing banking services, including experiencing bank account terminations and bank branch closures in the region. In addition, the World Bank and others have reported that some money transmitters have been losing access to banking services with depository institutions. Some have attributed these challenges to derisking.

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<sup>1</sup>We defined the Southwest border region as all counties that have at least 25 percent of their landmass within 50 miles of the U.S.-Mexico border. Thirty-three counties in Arizona, California, New Mexico, and Texas fell within this definition. The Organisation for Economic Co-operation and Development defines a fragile region or state as one that has weak capacity to carry out basic governance functions and lacks the ability to develop mutually constructive relations with society.

<sup>2</sup>The term "derisking" can be defined in a variety of ways. We developed this definition by reviewing various existing definitions used by international banking industry standard setters as well as guidance and other documentation issued by the federal banking regulators and the Department of the Treasury (Treasury), among other things. Our usage of the term does not refer to instances in which banks limit services or terminate relationships based on credible evidence of suspicious or illegal activity.

<sup>3</sup>Bank Secrecy Act, Pub. L. No. 91-508, 84 Stat. 1114-24 (1970) (codified as amended in scattered sections of 12 U.S.C., 18 U.S.C., and 31 U.S.C.).

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My remarks today are based on our February 2018 report on derisking along the Southwest border and our March 2018 report on remittances to fragile countries.<sup>4</sup> My statement will focus on the extent to which (1) banks are terminating accounts and closing branches in the Southwest border region and their reasons for any terminations and closures, (2) money transmitters are facing banking access challenges in remitting funds from the United States to selected fragile countries, and (3) relevant U.S. agencies have taken action to assess and respond to concerns about derisking and loss of banking access.

For the report on derisking in the Southwest border region, we analyzed data on Suspicious Activity Reports (SAR) and Currency Transaction Reports (CTR) as well as data on national and Southwest border region branch closures. We combined the data on branch closures with demographic, economic, and money laundering-related risk data and conducted an econometric analysis designed to examine the potential drivers of branch closures. Despite the robustness of our results and our efforts to control for relevant factors, our results are subject to a number of caveats associated with this type of empirical work and as such we interpret these results with some degree of caution. We also reviewed agency documentation and guidance to banks related to derisking and documentation on BSA/AML retrospective reviews that the Department of the Treasury's (Treasury) Financial Crimes Enforcement Network (FinCEN) and the federal banking regulators—the Board of Governors of the Federal Reserve System (Federal Reserve), Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC)—have conducted. Finally, we interviewed representatives from 19 Southwest border banks, a variety of banking industry groups and trade associations, and officials from FinCEN and the federal banking regulators.<sup>5</sup>

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<sup>4</sup>GAO, *Bank Secrecy Act: Derisking along the Southwest Border Highlights Need for Regulators to Enhance Retrospective Reviews*, GAO-18-263 (Washington, D.C.: Feb. 26, 2018); and *Remittances to Fragile Countries: Treasury Should Assess Risks from Shifts to Non-Banking Channels*, GAO-18-313 (Washington, D.C.: Mar. 8, 2018).

<sup>5</sup>We interviewed 4 of the 5 largest Southwest border banks (based on asset size). We interviewed an additional 15 banks based on the following criteria (1) the number of branches the bank operates in the Southwest border region, (2) the size of the bank based on assets, and (3) the bank's primary federal regulator. Responses from these banks are not generalizable to all Southwest border banks.

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For the report on remittances to fragile countries, we identified four case-study countries: Haiti, Liberia, Nepal, and Somalia.<sup>6</sup> We interviewed 12 out of 18 money transmitters that the World Bank identified as accounting for at least 80 percent of the market transfers from the United States to each of our case-study countries. We also interviewed officials from the federal banking regulators, Treasury, and eight extra-large banks.<sup>7</sup> The results of our interviews are not generalizable. In addition, we analyzed available data on remittances sent through banks as well as cash declarations at U.S. ports of exit.<sup>8</sup>

For both reports, we administered a web-based survey to a nationally representative sample of 406 banks in the United States, including 115 Southwest border banks. Additional details on our scope and methodology are available in our published reports.

We conducted the work on which this statement is based in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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<sup>6</sup>We selected these countries based on factors including their inclusion in the Organisation for Economic Co-operation and Development's States of Fragility reports from 2013 to 2015.

<sup>7</sup>Extra-large banks are those with greater than \$50 billion in assets.

<sup>8</sup>For available data on remittance flows through the banking channel, we analyzed Call Report data from the Federal Financial Institutions Examination Council. The Financial Institutions Regulatory and Interest Rate Control Act of 1978 established the council as a vehicle through which bank regulators could communicate formally. For data on remittance flows through nonbanking channels, we obtained and analyzed data from filings of Treasury's Financial Crimes Enforcement Network's (FinCEN) Form 105 – Report of International Transportation of Currency or Monetary Instruments.

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## Background

### BSA/AML Regulation and Enforcement for Banks and Money Transmitters

The BSA established reporting, recordkeeping, and other AML requirements for financial institutions. Regulation under and enforcement of BSA involves several federal agencies. FinCEN is responsible for administering the BSA and has authority for enforcing compliance with its requirements and implementing regulations, including through civil money penalties. FinCEN issues regulations under BSA and delegated BSA/AML examination authority for banks to the federal banking regulators.<sup>9</sup> The federal banking regulators have issued their own BSA regulations that require banks to establish and maintain a BSA/AML compliance program.<sup>10</sup> The federal banking regulators may take enforcement actions for violations of BSA/AML requirements. They may also assess civil money penalties against financial institutions and individuals independently, or concurrently with FinCEN.

Both federal and state agencies oversee money transmitters. FinCEN has delegated examination authority for BSA compliance for money transmitters to the Internal Revenue Service (IRS).<sup>11</sup> Money transmitters must register with FinCEN and provide information on their structure and ownership.<sup>12</sup> According to Treasury, in all states except one, money transmitters are required to obtain licenses from states in which they are incorporated or conducting business.<sup>13</sup>

All banks and money transmitters are required to establish an AML compliance program that includes policies, procedures, and processes

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<sup>9</sup>31 C.F.R. § 1010.810(b).

<sup>10</sup>The appropriate federal prudential regulators are required to prescribe regulations requiring the insured depository institutions under their supervision to establish and maintain procedures that are reasonably designed to assure and monitor the compliance of such institutions with the BSA. 12 U.S.C. § 1818(s). Regulations requiring the establishment of BSA compliance programs are codified at 12 C.F.R. § 21.21 (OCC); 12 C.F.R. § 208.63 (Federal Reserve); and 12 C.F.R. §§ 326.8 (FDIC).

<sup>11</sup>State regulators may also conduct safety and soundness examinations of nondepository financial institutions, such as money transmitters. The authority of states to regulate money transmitters varies from state to state.

<sup>12</sup>31 U.S.C. § 5330; 31 C.F.R. § 1022.380.

<sup>13</sup>Money transmitters are not required to obtain a license to operate in the state of Montana.

which, at a minimum, must provide for (1) a system of internal controls to ensure ongoing compliance, (2) a designated individual or individuals responsible for managing BSA compliance (BSA compliance officer), (3) training for appropriate personnel, and (4) independent testing for BSA/AML compliance. Additionally, as of May 11, 2018, banks and certain other financial institutions are required to implement appropriate risk-based procedures for conducting ongoing customer due diligence. Banks must also have policies and procedures for opening accounts and verifying the identity of each customer and monitoring transactions and reporting suspicious activity. Finally, banks and money transmitters must comply with certain reporting requirements, including the following:

- **CTR:** A bank must electronically file a CTR for each transaction in currency—such as a deposit or withdrawal—of more than \$10,000.<sup>14</sup>
- **SAR:** Banks are required to electronically file a SAR when a transaction involves or aggregates at least \$5,000 in funds or other assets, and the institution knows, suspects, or has reason to suspect that the transaction meets certain criteria qualifying as suspicious.<sup>15</sup>

#### Remittance Transfer Methods

Remittances can be sent through money transmitters and banks, among other organizations. International remittances through money transmitters and banks may include cash-to-cash money transfers, international wire transfers, some prepaid money card transfers, and automated clearinghouse transactions. If a remittance sender's bank does not have a direct relationship with the remittance recipient's bank, the bank-to-bank transfer scenario becomes more complicated. In such cases, one or more financial institutions may rely upon correspondent banking relationships to

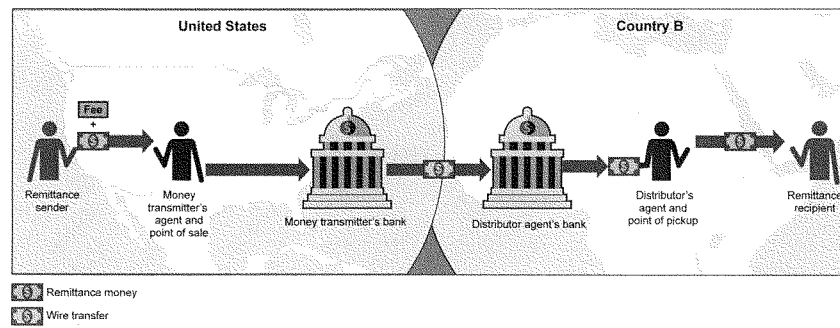
<sup>14</sup>Currency is defined as coin and paper money of the United States or of any other country that is designated as legal tender and that circulates and is customarily used and accepted as a medium of exchange in the country of issuance. 31 C.F.R. § 1010.100(m). Certain types of currency transactions need not be reported, such as those involving "exempt persons," a group which can include retail or commercial customers meeting specific criteria for exemption. See 31 C.F.R. § 1020.315.

<sup>15</sup>Banks are also required to file a SAR for known or suspected criminal violations involving insider abuse of any amount, as well as violations aggregating \$5,000 or more when a suspect can be identified and \$25,000 or more even without a potential suspect. See 12 C.F.R. §§ 21.11(c)(1)-(3), 163.180(d)(3)(i)-(iii) (OCC); 12 C.F.R. § 208.62(c)(1)-(3) (Federal Reserve); 12 C.F.R. § 353.3(a)(1)-(3) (FDIC). Money transmitters are also generally required to file SARs for suspicious transactions involving aggregate funds or assets of at least \$2,000. 31 C.F.R. § 1022.320(a).

complete the transaction.<sup>16</sup> A typical remittance sent through a bank may be in the thousands of dollars, while the typical remittance sent by money transmitters is usually in the hundreds of dollars.

Historically, many consumers have chosen to send remittances through money transmitters due to convenience, cost, familiarity, or tradition. Money transmitters typically work through agents—separate business entities generally authorized to, among other things, send and receive money transfers. Money transmitters generally operate through their own retail storefronts, or through grocery stores, financial services outlets, convenience stores, and other retailers that serve as agents. Figure 1 shows one type of common money transmitter transaction known as cash-to-cash transfer.

Figure 1: Example of Money Transmitter Cash-to-Cash Remittance Transfer Using a Bank Account



Source: GAO. | GAO-18-642T

<sup>16</sup>According to the International Monetary Fund, correspondent banking consists of a bilateral agreement, often involving a reciprocal cross-border relationship in multiple currencies. Consistent with the definition of a correspondent account in the PATRIOT Act, a correspondent account is any account established for a foreign financial institution to receive deposits from, or to make payments or other disbursements on behalf of, the foreign financial institution, or to handle other financial transactions related to such foreign financial institutions.

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**Remittances to Case Study Countries**

Remittances from the United States are an important source of funds for our case-study countries—Haiti, Liberia, Nepal, and Somalia.<sup>17</sup> The Organisation for Economic Co-operation and Development identified these countries as fragile states because of weak capacity to carry out basic governance functions, among other things, and their vulnerability to internal and external shocks such as economic crises or natural disasters.<sup>18</sup>

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**Risks Related to Money Laundering Appeared to Be a Factor in Reduced Access to Banking Services for Southwest Border Customers**

In our February 2018 report, we found that money laundering risk is high in the Southwest border region because of the high volume of cash transactions, the number of cross-border transactions, and foreign account holders. Our nationally representative survey found that many Southwest border banks may be engaging in derisking. Nationally, our econometric analysis suggested that counties that were urban, younger, had higher income, or had higher money laundering-related risk were more likely to lose branches. Money laundering-related risks were likely to have been relatively more important drivers of branch closures in the Southwest border region.

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**Southwest Border Banks Reported Heightened BSA/AML Compliance Risks and Challenges Due to Volume of High-Risk Customers**

In February 2018, we reported that money laundering risk is high in the Southwest border region because of the high volume of cash transactions, the number of cross-border transactions, and foreign account holders, according to bank representatives, federal banking regulators, and others we spoke with. Cash transactions increase the BSA/AML compliance risk for banks because the greater anonymity associated with using cash results in greater risk for money laundering or terrorist financing. Our review of data on banks' CTR filings confirmed that bank branches that operate in Southwest border region counties

<sup>17</sup>In 2015, estimated remittances from the United States to Haiti were about \$1.3 billion; to Liberia, about \$328 million; to Nepal, about \$320 million; and to Somalia, about \$215 million.

<sup>18</sup>For example, Haiti is the poorest country in the Western Hemisphere and has experienced political instability for most of its history. In 2003, Liberia officially ended its 14-year period of civil war but continued to face challenges with rebuilding its economy, particularly following the Ebola epidemic in 2014. Similarly, in 2006 Nepal ended a 10-year civil war, but in 2015 it was struck by an earthquake that caused widespread destruction. Somalia has endured political instability and civil conflict since 1969 and, according to a 2017 Department of State report, remained a safe haven for terrorists.



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handled more large cash transactions than bank branches elsewhere. Specifically, in 2016, bank branches in Southwest border region counties filed nearly 30 percent more CTRs, on average, than bank branches in comparable counties elsewhere in their same state, and about 60 percent more than those in other high-risk counties outside the region. Similar differences occurred in 2014 and 2015.<sup>19</sup>

We also reported that cross-border transactions are at a higher risk for money laundering because international transfers can present an attractive method to disguise the source of funds derived from illegal activity.<sup>20</sup> Southwest border banks cited foreign account holders as another type of high-risk customer for money laundering and terrorist financing. These types of customers are prevalent in the Southwest border region, examiners said, and can create challenges for banks to verify and authenticate their identification, source of funds, and source of wealth.

The volume of high-risk customers and cross-border transactions can lead to more intensive account monitoring and investigation of suspicious transactions, Southwest border bank representatives said. Performing effective due diligence and complying with customer identification requirements for higher-risk customers and transactions can be more

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<sup>19</sup>Comparable border-state counties are comprised of counties in Arizona, California, New Mexico, and Texas that are not Southwest border region counties. High-risk counties outside the region are counties that have been designated as High Intensity Financial Crime Areas (HIFCA) or High Intensity Drug Trafficking Areas (HIDTA) and are not located in the border states of Arizona, California, New Mexico, and Texas. Matching was performed based on similar rural-urban characteristics and county population. HIFCAs and HIFTAs aim to concentrate law enforcement efforts at the federal, state, and local levels to combat money laundering and drug trafficking in designated high-intensity money laundering zones and in areas determined to be critical drug-trafficking regions of the United States, respectively. See GAO-18-263 for more information. HIFCAs were conceived in the Money Laundering and Financial Crimes Strategy Act of 1998, Pub. L. No. 105-310, 112 Stat. 2941 (1998), and first announced in the 1999 National Money Laundering Strategy. The Office of National Drug Control Policy (ONDCP) Reauthorization Act of 1998 authorized the Director of ONDCP, upon consultation with certain specified federal and state entities, to designate any specified area of the United States as a HIDTA. Pub. L. No. 105-277, Div. C, Title VII, § 707, 112 Stat. 2681-670, 2681-686 (1998) (codified as amended at 21 U.S.C. § 2106).

<sup>20</sup>For example, representatives of one produce industry association we spoke with said produce distributors often import produce from Mexican farmers and pay them via wire transfer, which the farmers may then immediately withdraw in cash. Transactions that involve cross-border wire transfers and immediate withdrawals of cash may raise suspicion of money laundering that requires further scrutiny by the bank.

challenging because banks might need specialized processes for higher-risk customers and transactions than for those that are lower risk. Southwest border bank representatives we spoke with said addressing these compliance challenges can also require more resources for monitoring high-risk customers and investigating suspicious transactions. For example, in 2016, bank branches in the Southwest border region counties filed three times as many SARs, on average, as bank branches operating in other counties within Southwest border states and about 2.5 times as many SARs, on average, as bank branches in other high-risk financial crime or drug trafficking counties in nonborder states. These differences in SAR filings showed a similar pattern in 2014 and 2015.

**Some Account Terminations and Limitations Were Consistent with BSA/AML Purposes**

In February 2018, we found that most Southwest border banks reported terminating accounts for reasons related to BSA/AML risk. Based on our survey results, from January 1, 2014, through December 31, 2016, we estimated that almost 80 percent of Southwest border banks had terminated personal or business accounts for reasons related to BSA/AML risk.<sup>21</sup> The most common reasons related to BSA/AML risk Southwest border banks reported for terminating accounts were the filing of SARs associated with the accounts, the failure of the customer to respond adequately to requests for information as part of customer due diligence processes, and the reputational risk associated with the customer type (an estimated 93 percent, 80 percent, and 68 percent, respectively).<sup>22</sup> Of the high-risk businesses for money laundering and terrorist financing that we identified in our survey, cash-intensive small businesses (for example, retail stores, restaurants, and used car dealers) were the most common type of business accounts that Southwest border banks reported terminating accounts for reasons related to BSA/AML risk.

<sup>21</sup>The 95 percent confidence interval for this estimate was (69, 87). Southwest border banks include banks of all asset sizes from small to extra-large.

<sup>22</sup>The 95 percent confidence intervals for these estimates were (84, 97), (69, 89), and (55, 79), respectively. Other reasons that Southwest border banks cited for terminating accounts for BSA/AML risk reasons included: the cost of BSA/AML compliance made the customer type unprofitable, the customer type drew heightened BSA/AML regulatory oversight, the inability to manage the BSA/AML risk associated with the customer type, potential personal liability for BSA/AML compliance professionals, and negative news associated with the customer.

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Over 70 percent of Southwest border banks reported terminating these accounts.<sup>23</sup>

A majority of Southwest border banks and banks that did not operate in the Southwest border region (non-Southwest border banks) reported limiting or not offering accounts to certain types of businesses considered high risk for money laundering and terrorist financing, particularly money services businesses and foreign businesses.<sup>24</sup> The most common reason (cited by 88 percent of Southwest border banks) for limiting, or not offering, an account to these types of businesses was that the business type fell outside of the bank's risk tolerance—the acceptable level of risk an organization is willing to accept around specific objectives.<sup>25</sup> Similarly, 69 percent of Southwest border banks cited the inability to manage the BSA/AML risk associated with the customer (for example, because of resource constraints) as a factor for limiting, or not offering, accounts.<sup>26</sup> Similarly, the most common reason that non-Southwest border banks reported limiting, or not offering accounts, to certain types of businesses considered high risk for money laundering and terrorist financing was that the customer type fell outside of the bank's risk tolerance.<sup>27</sup>

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**Other Account  
Terminations and  
Limitations Raised  
Concerns about Derisking**

Further, in February 2018 we found that the second most common reason—cited by 80 percent of Southwest border banks—for limiting, or not offering, accounts to certain types of businesses considered high risk for money laundering and terrorist financing, was that the customer type drew heightened BSA/AML regulatory oversight—behavior that could

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<sup>23</sup>The 95 percent confidence interval for this estimate was (62, 84). The other four categories of high-risk business accounts we identified were money services businesses, domestic businesses engaged in cross-border trade, nontrade-related foreign businesses, and foreign businesses engaged in cross-border trade.

<sup>24</sup>For example, the estimates for Southwest border banks that have limited, or not offered, accounts to nontrade-related foreign businesses was 76 percent, money service businesses was 75 percent, and foreign businesses engaged in cross-border trade was 72 percent. The 95 percent confidence intervals for these estimates were (66, 84), (64, 83), and (62, 81), respectively.

<sup>25</sup>The 95 percent confidence interval for this estimate was (79, 94).

<sup>26</sup>The 95 percent confidence interval for this estimate was (57, 79).

<sup>27</sup>The estimate for non-Southwest border banks limiting, or not offering, accounts because the customer type fell outside of the bank's risk tolerance was 82 percent. The 95 percent confidence interval for this estimate was (70, 91).

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indicate derisking.<sup>28</sup> For example, representatives from one Southwest border bank explained that they no longer offer accounts to money services businesses because they want to be viewed from a good standpoint with their regulator. They added that banking for these types of customers is very high risk for the bank with very little reward. Another bank that operates in the Southwest border region explained that rather than being able to focus on their own BSA/AML risk assessment and the performance of accounts, they feel pressured to make arbitrary decisions to close accounts based on specific concerns of their examiners.

Several Southwest border bank representatives also described how recent BSA/AML law enforcement and regulatory enforcement actions have caused them to become more conservative in the types of businesses for which they offer accounts. In addition, while banks may terminate accounts because of SAR filings as a method to manage money laundering and terrorist financing risk and to comply with BSA/AML requirements, some of these terminations may be related to derisking. For example, some Southwest border bank representatives we spoke with for our Southwest border report, as well as other banks and credit unions we spoke with in a February 2009 review, told us that they have filed SARs to avoid potential criticism during examinations, not because they thought the observed activity was suspicious.<sup>29</sup> Non-Southwest border banks also commonly cited the inability to manage risk associated with the customer type and heightened regulatory oversight as reasons for limiting, or not offering, accounts.

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<sup>28</sup>The 95 percent confidence interval for this estimate was (89, 89). Other reasons that Southwest border banks cited for limiting, or not offering, accounts to certain types of businesses considered high risk for money laundering and terrorist financing included: the cost of BSA/AML compliance made the customer type unprofitable, potential personal liability for BSA/AML compliance professionals, reputational risk associated with the customer type, and compliance risk other than BSA/AML associated with the customer type.

<sup>29</sup>See GAO, *Bank Secrecy Act: Suspicious Activity Report Use Is Increasing, but FinCEN Needs to Further Develop and Document Its Form Revision Process*, GAO-09-226 (Washington, D.C.: Feb. 27, 2009).

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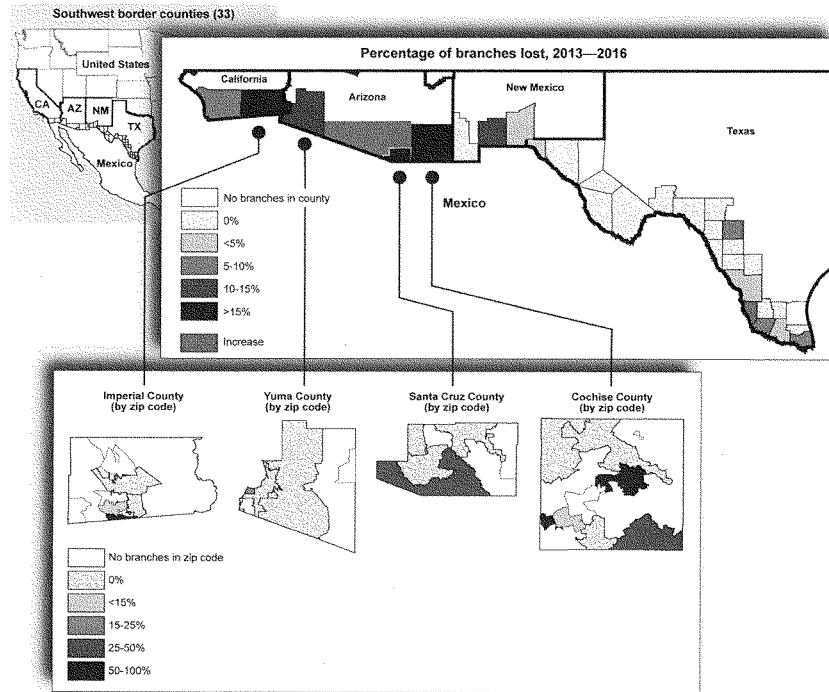
**Southwest Border Bank  
Branch Closures Have  
Been Concentrated in a  
Small Number of  
Communities**

Counties in the Southwest border region have been losing bank branches since 2012, similar to national and regional trends, as well as trends in other high-risk financial crime or drug trafficking counties that are outside the region. In February 2018, we found that most of the 32 counties (18 counties or nearly 60 percent) comprising the Southwest border region did not lose bank branches from 2013 through 2016, but 5 counties lost 10 percent or more of their branches over this time period (see top panel of fig. 2).<sup>30</sup> Those 5 counties are Cochise, Santa Cruz, and Yuma, Arizona; Imperial, California; and Luna, New Mexico.

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<sup>30</sup>Our analysis of the number of branches was based on FDIC's Summary of Deposits database. This database records bank branch information as of June 30 each year. One of the 33 counties in our defined Southwest border region—Kenedy County, Texas—did not have a bank branch from June 30, 2000, through June 30, 2016, and therefore was not included in our analysis of branch closures in the region. Our analysis of bank branches included both full-service and limited-service branches. Limited-service branches provide some conveniences to bank customers but generally offer a reduced set of bank services.

Figure 2: Bank Branch Closures in the Southwest Border Region, 2013–2016



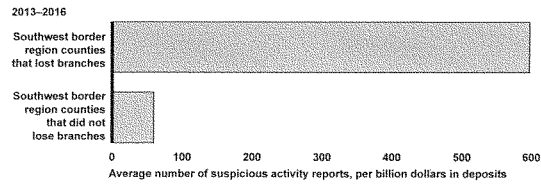
Sources: GAO analysis of Federal Deposit Insurance Corporation data; MapInfo. | GAO-18-642T

Within those counties we identified as having the largest percentage loss of branches, sometimes those losses were concentrated in smaller communities within the county (see bottom panel of fig. 2). For example, Calexico in Imperial County, California, lost 5 of its 6 branches from 2013 through 2016. In Santa Cruz County in Arizona, one zip code in Nogales

accounted for all of the branch losses in the county from 2013 through 2016, losing 3 of its 9 branches. More generally, branch losses varied substantially across different zip codes in a county (see for example bottom panel of fig. 2). In other instances, counties that lost a relatively small share of their branches contained communities that lost a more substantial share—for example San Ysidro in San Diego County lost 5 of its 12 branches (about 42 percent) while the county as a whole lost only 5 percent of its branches from 2013 through 2016.

Based on our analysis, counties losing branches in the Southwest border region tended to have substantially higher SAR filings, on average, than Southwest border region counties that did not lose branches. That is, counties that lost branches from 2013 through 2016 had about 600 SAR filings per billion dollars in deposits, on average, and counties that did not lose branches had about 60 SAR filings per billion dollars in deposits, on average (see fig. 3).

Figure 3: Average Number of SARs Filed per Billion Dollars in Deposits, 2014



Source: GAO analysis of Federal Deposit Insurance Corporation and Financial Crimes Enforcement Network data. | GAO-18-642T

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**Empirical Evidence  
Suggested Demographic  
and Money Laundering-  
Related Risk Factors Are  
Drivers of Branch  
Closures**

The econometric models we developed and estimated for our February 2018 report generally found that demographic and money laundering-related risk factors were important predictors of national bank branch closures.<sup>31</sup> In general, our results suggested that counties were more likely to lose branches, all else equal, if they were (1) urban, had a higher per capita personal income, and had a younger population (proportion under 45); or (2) designated as a HIFCA or HIDTA county, or had higher SAR filings. We termed the latter three characteristics (HIFCA, HIDTA, and SAR filings) “money laundering-related risk factors.”

Our results were consistent with those demographic characteristics associated with the adoption of mobile banking. As such, our results were consistent with the hypothesis that mobile banking is among the factors leading some banks to close branches. The most urban counties were about 22 percentage points more likely to lose one or more branches over the next year than the most rural counties. A county with 70 percent of the population under 45 was about 9 percentage points more likely to lose one or more branches over the next year than a county with half the population under 45. A county with per capita income of \$50,000 was about 7 percentage points more likely to lose one or more branches over the next year than a county with per capita income of \$20,000.

Money laundering-related characteristics of a county were also important predictors of branch closures in our models. HIDTA counties were about 11 percentage points more likely to lose one or more branches over the next year than non-HIDTA counties (the effect in HIFCA counties is less significant statistically and smaller in magnitude). A county with 200 SARs filed per billion dollars in bank deposits was about 8 percentage points

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<sup>31</sup>We estimated a large number of econometric models to ensure that our results were generally not sensitive to small changes in our model. Despite the robustness of our results and our efforts to control for relevant factors, our results are subject to a number of caveats associated with this type of empirical work. For example, our regression models may be subject to omitted variable bias—it is unlikely that we were able to quantify and include all relevant factors in bank branching decisions. As such, we interpret these results with some degree of caution. While our models are unable to definitively identify the causal effect of BSA/AML regulation on branch closures from these money laundering-related risk factors, the impact of the SAR variables, in particular, could reflect a combination of BSA/AML compliance effort and the underlying level of suspicious or money laundering-related activity in a county.



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more likely to lose one or more bank branches over the next year than a county where no bank branch had filed a SAR.<sup>32</sup>

Money laundering-related risk factors were likely to have been relatively more important drivers of branch closures in the Southwest border region because it had much higher SAR filings and a larger share of counties designated as HIDTAs than the rest of the country. More generally, given the characteristics of Southwest border counties and the rest of the United States, our models suggested that while demographic factors have been important drivers of branch closures in the United States overall, risks associated with money laundering were likely to have been relatively more important in the Southwest border region.

Southwest border bank representatives we interviewed told us they considered a range of factors when deciding whether or not to close a branch. Nearly half of the Southwest border bank representatives we spoke with (4 of 10), mentioned that BSA/AML compliance costs could be among the factors considered in determining whether or not to close a branch.<sup>33</sup>

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<sup>32</sup>Southwest border bank officials we spoke with generally said that SAR filings were a time- and resource-intensive process, and that the number of SARs filings—to some extent—reflected the level of effort, and overall BSA compliance risk, faced by the bank. Therefore, the impact of SAR variables in our models could reflect a combination of (1) the extent of BSA/AML compliance effort and risk faced by the bank, as expressed by bank officials, and (2) the underlying level of suspicious or money laundering-related activity in a county.

<sup>33</sup>The total number of Southwest border banks that we spoke with cited here is less than the total number of Southwest border banks we spoke with referenced earlier. The difference reflects the fact that not all Southwest border banks we spoke with had closed branches in the 5 years previous to our interview or that the bank representatives present for the interview were not knowledgeable about their banks' decisions in closing branches.

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**Money Transmitters  
Serving Selected  
Fragile Countries  
Noted Loss of  
Banking Access,  
Although Treasury  
Saw No Reduction in  
Remittance Flows**

In March 2018, we found that money transmitters serving Haiti, Liberia, Nepal, and especially Somalia reported losing bank accounts or having restrictions placed on them, which some banks confirmed. As a result, some money transmitters relied on nonbanking channels, such as cash couriers, to transfer remittances. All of the 12 money transmitters we interviewed at the time reported losing some banking relationships in the last 10 years. Some money transmitters, including all 4 that served Somalia, said they relied on nonbanking channels, such as moving cash, to transfer funds, which increased their operational costs and exposure to risks. Further, in our interviews some banks reported that they had closed the accounts of money transmitters because of the high cost of due diligence actions they considered necessary to minimize the risk of fines under BSA/AML regulations. Treasury officials noted that despite information that some money transmitters have lost banking accounts, Treasury saw no evidence that the volume of remittances was falling or that costs of sending remittances were rising.

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**All Money Transmitters We  
Interviewed Reported  
They Lost Bank Accounts,  
Which for Many Resulted  
in Higher Costs and a Shift  
to Nonbanking Channels**

All 12 money transmitters we interviewed for our March 2018 report stated that they or their agents had lost accounts with banks during the last 10 years. All 4 Somali money transmitters and many agents of the 2 Haitian money transmitters we spoke with reported they had lost some bank accounts, and 2 of the 4 Somali money transmitters reported losing all bank accounts. Additionally, all 4 large money transmitters that process transfers globally (including to our case-study countries of Haiti, Liberia, and Nepal) also reported that their agents had lost accounts.<sup>34</sup> Almost all of the money transmitters said they also faced difficulties in getting new accounts. While some money transmitters said the banks that closed their accounts did not provide a reason, in other cases, money transmitters said the banks told them that they had received pressure from regulators to terminate money transmitter accounts.

As a result of losing access to bank accounts, several money transmitters, including all of the Somali money transmitters, reported that they were using nonbanking channels to transfer funds. In some cases the money transmitter was forced to conduct operations in cash, which increased the risk of theft and forfeitures and led to increased risk for agents and couriers. Nine of the money transmitters that we interviewed

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<sup>34</sup>One of the large money transmitters also facilitates remittances to Somaliland, a semi-autonomous region of Somalia.

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reported they rely on couriers or armored trucks to transport cash domestically (to the money transmitter's main offices or bank) or, in the case of Somalia, internationally. Money transmitters reported they use cash couriers either because the money transmitter or their agents had lost bank accounts or because it was cheaper to use armored trucks than banks to move funds.

Money transmitters we interviewed reported increased costs associated with moving cash and bank fees. Two of the money transmitters we spoke to stated that they did not have options other than to pay any fees the bank required due to the difficulty in finding new bank accounts. Money transmitters with access to bank accounts reported that bank charges for services had in some cases doubled or tripled, or were so high that it was less expensive to use a cash courier. For example, some money transmitters stated that their banks charged a monthly fee for compliance-related costs that ranged from \$100 a month to several thousand dollars a month.

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**Some Banks Reported Closing or Denying Accounts for Money Transmitters, Citing Insufficient Profit to Offset Risks and Costs**

Most of the banks we interviewed for our March 2018 report expressed concerns about account holders who are money transmitters because they tended to be low-profit, high-risk clients. Most of the banks we interviewed that serve money transmitters stated that BSA/AML compliance costs have significantly increased in the last 10 years because they had to hire additional staff and upgrade information systems to conduct electronic monitoring of all transactions processed through their system. Some banks indicated in our survey and interviews that the revenue from money transmitter accounts was at times not sufficient to offset the costs of BSA/AML compliance, leading to terminations and restrictions on money transmitter accounts. A few banks we interviewed stated that they do not allow money transmitters to open accounts because of the BSA/AML compliance resources they require.

Banks also expressed concerns over the adequacy of money transmitters' ability to conduct due diligence on the money transmitter's customers. A few banks we interviewed expressed concern that they would be held responsible if, despite the bank carrying out due diligence, authorities detected an illicit transaction had been processed through the bank on behalf of a money transmitter.

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**Treasury Officials Said  
Remittance Flows to  
Fragile Countries Have  
Not Declined; Remittance  
Senders Reported No  
Major Difficulties**

In our March 2018 report, we found that Treasury officials reported remittances continue to flow to fragile countries even though money transmitters faced challenges. Through engagement with money transmitters and banks, Treasury found some evidence of money transmitter bank account closures. However, according to Treasury officials, World Bank estimates of remittance flows show that the volume of international transfers from the United States has continued to increase. At the same time, World Bank data indicate that the global average cost of sending remittances has continued to decrease. Citing these trends, and anecdotal evidence from Treasury's engagement with banks, the officials stated that there were no clear systemic impacts on the flow of remittances from closures of money transmitter bank accounts and correspondent banking relations.

Treasury officials acknowledged that such closures can be a significant challenge for money transmitters that serve certain regions or countries, including Somalia. Further, Treasury officials said they were aware that some Somali money transmitters resorted to nonbanking channels by carrying cash overseas. They noted that although physically moving cash is risky, it is not unlawful. Additionally, Treasury officials stated that the use of cash couriers to remit funds had not been a concern for regulators because this practice had not increased the remittance fees that money transmitters charge their consumers.

Remittance senders in the United States who remit to our case-study countries reported that they frequently used money transmitters and had not encountered major difficulties in sending remittances. Senders told us that they generally preferred using money transmitters over other methods because money transmitters were cheaper than banks and were quicker in delivering the funds than other methods. In addition, money transmitters were often more accessible for recipients collecting the remittances because the money transmitters had more locations than banks in recipient countries. However, some remittance senders told us that they were unable to send large amounts of money through money transmitters.

**Regulators Have Not Evaluated All Factors Influencing Banks to Derisk and Treasury Lacks Data Needed to Assess Possible Effects on Remittance Flows**

In February 2018 we reported that to address concerns about derisking, FinCEN and the federal banking regulators had taken actions including issuing guidance to banks and conducting some evaluations to assess the extent to which derisking is occurring. However, the actions regulators had taken to address concerns raised in their BSA/AML regulatory reviews were limited in scope (for example, they focused primarily on the burden resulting from the filing of CTRs and SARs) and had not evaluated all factors that may influence banks to derisk or close branches. Moreover, in March 2018 we found that Treasury could not assess the effects of money transmitters' loss of banking access on remittance flows because existing data did not allow Treasury to identify remittances transferred through banking and nonbanking channels.

**Regulators Issued Guidance and Took Some Actions Related to Derisking**

In February 2018, we reported that FinCEN and the federal banking regulators responded to concerns about derisking on a national level by issuing guidance to banks and conducting some evaluations within their agencies to understand the extent to which derisking is occurring. The guidance issued by regulators was aimed at clarifying BSA/AML regulatory expectations and discouraging banks from terminating accounts without evaluating risk presented by individual customers or banks' abilities to manage risks. The guidance generally encouraged banks to use a risk-based approach to evaluate individual customer risks and not to eliminate entire categories of customers. Some of the guidance issued by regulators attempted to clarify their expectations specifically for banks' offering of services to money services businesses, including money transmitters. For example, in March 2005, the federal banking regulators and FinCEN issued a joint statement on providing banking services to money services businesses to clarify the BSA requirements and supervisory expectations as applied to accounts opened or maintained for this type of customer. The statement acknowledged that money services businesses were losing access to banking services as a result of concerns about regulatory scrutiny, the risks presented by these types of accounts, and the costs and burdens associated with maintaining such accounts.<sup>35</sup>

<sup>35</sup>In their *Joint Statement on Providing Banking Services to Money Services Businesses*, FinCEN and the federal banking agencies, including the Federal Reserve, OCC, FDIC, and the National Credit Union Administration, advised banks that the risk posed by money services businesses should be assessed on a case-by-case basis. The agencies noted that these businesses provide valuable financial services to individuals without access to the formal banking sector.

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The agencies issuing these guidance documents told us they took some steps to assess the effect of their guidance on bank behavior. For example, Treasury officials said that Treasury periodically engaged with banks and money transmitters on an ad hoc basis to learn their views and gain insight into their concerns. According to Federal Reserve officials, anecdotal information suggested that some money transmitters lost bank accounts after FinCEN and federal banking agencies issued the joint guidance in 2005, and that outcome was contrary to the regulators' intent. To address concerns about the guidance, according to these officials, Treasury held several public discussions on money transmitter account terminations.

In addition to issuing guidance, FDIC and OCC took some steps aimed at trying to determine why banks may be terminating accounts because of perceived regulatory concerns. For example, in January 2015, FDIC issued a memorandum to examiners establishing a policy that examiners document and report instances in which they recommend or require banks to terminate accounts during examinations. From January 2015 through December 2017, FDIC officials stated that examiners had not documented any recommendations or requirements for account terminations. In 2016, OCC reviewed how the institutions it supervises develop and implement policies and procedures for evaluating customer risks as part of their BSA/AML programs and for making risk-based determinations to close customer accounts. OCC focused its review on certain large banks' evaluation of risk for foreign correspondent bank accounts. This effort resulted in OCC issuing guidance to banks on periodic evaluation of the risks of foreign correspondent accounts. The federal banking regulators also met with residents and businesses in the Southwest border region to discuss concerns about derisking in the region.

Treasury and the federal banking regulators also participated in a number of international activities related to concerns about the decline in the number of correspondent banking and money services business accounts. For example, FDIC, OCC, and the Federal Reserve participate in the Basel Committee on Banking Supervision's Anti-Money Laundering/Counter Financing of Terrorism Experts Group. Recent efforts of the group involved revising guidelines to update and clarify correspondent banking expectations. Treasury leads the U.S. engagement with the Financial Action Task Force—an intergovernmental body that sets standards for combating money laundering, financing of terrorism, and other related threats to the integrity of the international

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financial system—which has issued guidance on correspondent banking and money services businesses.

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**BSA/AML Regulatory Reviews Had Not Evaluated All Factors Influencing Banks to Derisk and Close Branches**

Executive orders encourage and legislation requires FinCEN and the federal banking regulators to review existing regulations to determine whether they should be retained, amended, or rescinded, among other things. Retrospective reviews of existing rules help agencies evaluate how existing regulations are working in practice. Recent presidents have directed agencies to evaluate or reconsider existing regulations.<sup>36</sup> In addition to the executive orders, the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) requires federal banking regulators to review the regulations they prescribe not less than once every 10 years and request comments to identify outdated, unnecessary, or unduly burdensome statutory or regulatory requirements.<sup>37</sup>

In February 2018, we reported that FinCEN and the federal banking regulators had all participated in retrospective reviews of different parts of the BSA/AML regulations. For example, FinCEN officials told us that they review each new or significantly amended regulation to assess its clarity and effectiveness within 18 months of its effective date. As part of fulfilling their requirements under EGRPRA, the federal banking regulators—through the Federal Financial Institutions Examination Council (FFIEC)—have also participated in retrospective reviews of BSA/AML regulations.<sup>38</sup>

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<sup>36</sup>For example, in 2011 President Obama issued Executive Orders 13563 and 13579. Among other provisions, Executive Orders 13563 and 13579 require executive branch agencies and encourage independent regulatory agencies, such as the federal banking regulators, respectively, to develop and implement retrospective review plans for existing significant regulations. See Exec. Order No. 13563, 3 C.F.R. § 13563 (2012); Exec. Order No. 13579, 3 C.F.R. § 13579 (2012). Significant regulatory actions are those likely to result in a rule that may have an annual effect on the economy of \$100 million or more, among other things. See Exec. Order No. 12866 § 3(f), 3 C.F.R. § 12866 (1993). Some BSA rules have been deemed significant regulatory actions. See e.g., Customer Due Diligence Requirements for Financial Institutions, 81 Fed. Reg. 29398 (May 11, 2016). Further, the Trump Administration has continued to focus on the need for agencies to improve regulatory effectiveness while reducing regulatory burdens. Executive Order 13777, issued by President Trump in February 2017, also reaffirms the objectives of previous executive orders and directs agency task forces to identify regulations which, among other criteria, are outdated, unnecessary, or ineffective. Exec. Order No. 13777, (to be codified at 3 C.F.R. § 13777 (2018)).

<sup>37</sup>The Economic Growth and Regulatory Paperwork Reduction Act of 1996, Pub. L. No. 104-208, § 2222, 110 Stat. 3009-414-15 (1996) (codified at 12 U.S.C. § 3311).

<sup>38</sup>While EGRPRA does not govern BSA itself, it covers the regulations under the federal banking regulators' supervisory authority promulgated under BSA.

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As part of the 2017 EGRPRA review, FFIEC received several public comments on BSA/AML requirements, including increasing the threshold for filing CTRs, the SAR threshold, and the overall increasing cost and burden of BSA compliance.<sup>39</sup> FinCEN officials and the federal banking regulators stated that the agencies are working to address the BSA-related EGRPRA comments—particularly those related to CTR and SAR filing requirements—through the BSA Advisory Group (BSAAG).<sup>40</sup>

However, the actions FinCEN and the federal banking regulators took related to derisking were not aimed at addressing and, if possible ameliorating, the full range of factors that influence banks to engage in derisking, in particular banks' regulatory concerns and BSA/AML compliance efforts. Further, the actions regulators took to address concerns raised in BSA/AML retrospective reviews focused primarily on the burden resulting from the filing of CTRs and SARs, but these actions did not evaluate how regulatory concerns may influence banks to engage in derisking or close branches. Federal internal control standards call for agencies to analyze and respond to risks to achieving their objectives.<sup>41</sup> Further, guidance implementing executive orders states that agencies should consider conducting retrospective reviews on rules that

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<sup>39</sup>See Joint Report to Congress: Economic Growth and Regulatory Paperwork Reduction Act, 82 Fed. Reg. 15900 (Mar. 30, 2017). The first EGRPRA review was issued in July 2007 and also discussed issues related to BSA. The review highlighted concerns related to CTR and SAR filing requirements, the need for additional guidance on customer identification requirements, and recordkeeping requirements. Joint Report to Congress, July 31, 2007; Economic Growth and Regulatory Paperwork Reduction Act, 72 Fed. Reg. 62036 (Nov. 1, 2007).

<sup>40</sup>The federal banking regulators referred the comments to FinCEN. FinCEN is not part of the EGRPRA review and is not required to consider the comments; however, in its response in the 2017 EGRPRA report, the agency stated that it finds the information helpful when assessing BSA requirements. The Annunzio-Wylie Anti-Money Laundering Act of 1992 requires the Secretary of the Treasury to establish a Bank Secrecy Act Advisory Group on Reporting Requirements consisting of representatives of the Departments of Treasury and Justice, the Office of National Drug Control Policy, and other interested persons, financial institutions, and trades and businesses subject to the reporting requirements of the Currency and Foreign Transactions Reporting Act (known as the Bank Secrecy Act) or Section 60501 of the Internal Revenue Code of 1986.

<sup>41</sup>See GAO, Standards for Internal Control in the Federal Government, GAO-14-704G (Washington, D.C.: Sept. 10, 2014).



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unanticipated circumstances have overtaken.<sup>42</sup> In February 2018, we concluded that without assessing the full range of BSA/AML factors that may be influencing banks to derisk or close branches, FinCEN, the federal banking regulators, and Congress would not have the information they need to determine if adjustments are needed to ensure that the BSA/AML regulations and their implementation are achieving their regulatory objectives in the most effective and least burdensome way.

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**U.S. Data on Remittances Did Not Allow Treasury to Assess the Effects of Money Transmitters' Loss of Banking Access on Remittance Flows to Fragile Countries**

In March 2018, we found that Treasury could not assess the effects of money transmitters' loss of banking access on remittance flows because existing data did not allow Treasury to identify remittances transferred through banking and non-banking channels.

Recent efforts to collect international remittance data from banks and credit unions did not include transfers these institutions make on behalf of money transmitters. Since these data collection efforts are designed to protect U.S. consumers, the remittance data that banks and credit unions report are limited to remittances individual consumers send directly through these institutions. Additionally, as of the first quarter of 2018, about half the states (24) adopted reports to collect remittance data from money transmitters and of these, 12 states had made it mandatory to report remittance data by destination country. However, these data do not distinguish money transmitters' use of banking and nonbanking channels to transfer funds.

Finally, we found that while Treasury has a long-standing effort to collect information on travelers transporting cash from U.S. ports of exit, this information did not identify cash transported for remittances. We concluded that without information on remittances sent through banking and nonbanking channels, Treasury could not assess the effects of money transmitter and foreign bank account closures on remittances, especially shifts in remittance transfers from banking to nonbanking channels for fragile countries. Nonbanking channels are generally less transparent than banking channels and thus more susceptible to the risk

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<sup>42</sup>Memorandum from Cass R. Sunstein, Administrator, Office of Management and Budget, to the Heads of Executive Departments and Agencies, and of Independent Regulatory Agencies (Feb. 2, 2011), available at [https://www.va.gov/ORM/docs/EO\\_OIRA\\_Guidance\\_M11-10.pdf](https://www.va.gov/ORM/docs/EO_OIRA_Guidance_M11-10.pdf); Memorandum from Cass R. Sunstein, Administrator, Office of Management and Budget, to the Heads of Independent Regulatory Agencies (July 22, 2011), available at <https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/memoranda/2011/m11-28.pdf>.

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of money laundering and other illicit financial transactions. Additionally, while risks associated with shifts of remittances to nonbanking channels may vary by country, these risks are likely greater for fragile countries, such as Somalia, where the United States has concerns about terrorism financing.

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### Conclusions and Recommendations for Executive Action

The collective findings from our work indicate that BSA/AML regulatory concerns have played a role in banks' decisions to terminate and limit accounts and close branches. However, the actions taken to address derisking by the federal banking regulators and FinCEN and the retrospective reviews conducted on BSA/AML regulations had not fully considered or addressed these effects. As a result, in our February 2018 report, we recommended that FinCEN and the three banking regulators in our review—FDIC, the Federal Reserve, and OCC—jointly conduct a retrospective review of BSA/AML regulations and their implementation for banks, focusing on how banks' regulatory concerns may be influencing their willingness to provide services. In their written responses, the Federal Reserve, FDIC, and OCC agreed to leverage ongoing interagency work reviewing BSA/AML regulations and their implementation for banks to address our recommendation. GAO requested comments from Treasury, but none were provided.

A lack of data on remittances sent through banking and nonbanking channels limits the ability of Treasury to assess the effects of money transmitter and foreign bank account closures on remittances, in particular shifts of remittances to non-banking channels for fragile countries. Therefore, in the March 2018 report we recommended that Treasury assess the extent to which shifts in remittance flows from banking to non-banking channels for fragile countries may affect Treasury's ability to monitor for money laundering and terrorist financing and, if necessary, should identify corrective actions. GAO requested comments from Treasury, but none were provided.

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Chairman Luetkemeyer, Ranking Member Clay, and members of the Subcommittee, this concludes my statement. I would be pleased to respond to any questions you may have.

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**GAO Contact and  
Staff  
Acknowledgments**

If you or your staff have any questions about the issues related to access to banking services along the Southwest border in this testimony or the related report, please contact Michael E. Clements, Director, Financial Markets and Community Investment, at (202) 512-8678 or [clementsm@gao.gov](mailto:clementsm@gao.gov). For questions about the issues related to remittance flows to fragile nations in this testimony or related report, please contact Thomas Melito, Managing Director, International Affairs and Trade, at (202) 512-9601, or [melitot@gao.gov](mailto:melitot@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. GAO staff who made key contributions to this testimony are Lawrence Evans, Jr. (Managing Director), Stefanie Jonkman (Assistant Director), Mona Sehgal (Assistant Director), Christine McGinty (Analyst in Charge), Kyerion Printup, Madeline Messick, and David Dayton. Other staff who made key contributions to the reports cited in the testimony are identified in the source products.

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Center for a  
New American  
Security

26 June 2018

Testimony before the Subcommittee on Financial Institutions and Consumer Credit  
Committee on Financial Services, U.S. House of Representatives

***International and Domestic Implications of De-Risking***

The Honorable Sue E. Eckert  
Adjunct Senior Fellow, Center for a New American Security

Chairman Luetkemeyer, Ranking Member Clay, and distinguished members of the subcommittee, thank you for the opportunity to testify today on the international and domestic implications of de-risking. I applaud your efforts to call attention to the critically important phenomenon of de-risking, something that is not well understood but which has profound impacts on some of the most vulnerable populations. De-risking affects financial inclusion and constitutes an impediment to development. It is particularly disconcerting as it directly affects humanitarian assistance to those most in need, and at a time when those needs are growing. The U.S. has a unique role to play in addressing de-risking globally, as the dominance of the U.S. dollar and American regulatory policies set the stage for other countries regardless of where transactions take place.

My comments today, focused primarily on the impact of de-risking on charities and nonprofit organizations (NPOs)<sup>1</sup> are based on the research I conducted for the February 2017 report, *Financial Access for U.S. Nonprofits*, commissioned by the Charity & Security Network (C&SN) and supported by the Bill and Melinda Gates Foundation. While I am currently involved with the World Bank/ACAMS Initiative on Financial Access for NPOs, the views I express today are my own.

Financial tools, in particular, Anti-Money Laundering (AML), Countering the Financing of Terrorism (CFT), and international sanctions policies, have become essential instruments in protecting the integrity of the global financial system and promoting international security. In recent years, however, the unintended consequences of these policies on some developing countries and certain sectors such as money service businesses (MSBs) and humanitarian organizations have become apparent. Anecdotal examples regarding the significant challenges charities face when financial institutions terminate or restrict business relationships to avoid rather than manage risk abound. Without the ability to transfer funds internationally, NPOs are unable to deliver vital humanitarian and development assistance.

<sup>1</sup> The term nonprofit organization (NPO) has been defined by FATF as: "A legal person or arrangement or organisation that primarily engages in raising or disbursing funds for purposes such as charitable, religious, cultural, educational, social or fraternal purposes, or for the carrying out of other types of "good works."

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#### Drivers of de-risking

De-risking is a complex phenomenon driven by the multiple considerations and calculations by financial institutions. Among these various drivers are concerns for reputational and liability risk, profitability, business strategy, the cost of implementing AML/CFT/sanctions and other regulatory requirements, and exposure to penalties by supervisory and law enforcement authorities.

Compliance-related concerns by banks and regulatory expectations are among the most frequently cited reasons for de-risking. For many financial institutions, decisions to decline to provide financial services relate to perceptions that certain customers such as NPOs are high-risk, and certain countries (subject to sanctions or where non-state armed groups such as ISIS and al Shabaab are active or exercise territorial control) are high-risk jurisdictions. Such locations are often the places where humanitarian and development NPOs operate, creating compliance challenges for banks in facilitating transactions to these regions. Regulatory requirements and expectations, as well as routine second-guessing by examiners of financial institutions' decisions require banks to undertake extensive and expensive efforts to mitigate risks and justify decisions, frequently tipping the risk-reward scale toward exiting such relationships. Despite statements from government officials, financial institutions perceive a clear disconnect between what policy officials say and what happens at the individual bank examination level. This reluctance has been fueled by a fear of penalties.

In recent years, several major banks have had large fines levied for AML/CFT/sanctions violations; many financial institutions are still under deferred prosecution agreements or consent orders requiring substantial compliance reforms and costly monitoring which has had a deterring effect on other banks. In the aftermath of the 2008 financial crises, U.S. regulators (on both the federal and state levels) cracked down on regulatory violations, imposing unprecedented fines. Over the last 15 years, both the number and value of AML-related fines have increased in both the U.S. and the U.K.

The upward trend in U.S. enforcement actions and fines against banks, along with the existing regulatory complexity in the AML/CFT/sanctions field, result in significantly increased compliance costs for financial institutions. Financial institutions consistently note that decreased profitability resulting from the increased monitoring and compliance costs of AML/CFT regulations as a key driver of de-risking. Some reports place the additional burden at upwards of \$4 billion annually. One bank reportedly employed 4,000 additional compliance staff in one year, at a cost of \$1 billion. According to a 2016 survey by the Association of Certified Money-Laundering Specialists (ACAMS), three-fifths of respondents cited enhanced regulatory expectations as the greatest AML compliance challenge. Supervisory actions including personal liability of compliance officers for regulatory violations further contributes to escalating costs and challenges. This trend is not limited to the U.S.; a 2015 survey of Commonwealth members identified decreased profitability resulting from the increased monitoring and compliance costs of AML/CFT regulations as a key driver of de-risking. Added to this is the fact that NPO

accounts are not usually hugely profitable.

Countries base their AML/CFT frameworks on international standards established by the Financial Action Task Force (FATF). Central to the 40 recommendations issued in 2012 is the risk-based approach that calls for financial institutions to establish systems to assess client risk and adopt measures to mitigate those risks. When considering the potential risks posed by customers, banks need to take appropriate steps to identify and assess their money laundering and terrorist financing risks (for customers, countries or geographic areas; and products, services, transactions or delivery channels). Financial institutions are required to have policies, controls, and procedures that enable them to effectively manage and mitigate the risks that have been identified. Since the introduction of the risk-based approach, however, regulations have not fully incorporated it so financial institutions can effectively implement a risk-based approach; the result has been persistent termination or restrictions on relationships with countries or customer categories to avoid rather than manage risks. Numerous studies have shown that de-risking has impacted correspondent banking, MSBs, and NPOs' transactions, among others, posing a threat to financial connectivity, financial inclusion, and financial transparency.

Significant analysis has been undertaken on the decline in correspondent banking by the World Bank and the Financial Stability Board. Such reports confirm reduced correspondent banking relationships are also pressuring NPOs and MSBs. The Financial Stability Board in 2017 collected information on the motives behind respondent banks' decisions to terminate services to customers, including NPOs, money transfer operators, payment service providers, Politically Exposed Persons, and other financial institutions. The main drivers reported were the perceived risk (35%) or the "additional KYC (Know Your Customer) or CDD (Customer Due Diligence) measures" associated with these customers (34%) and therefore presumably related to AML/CFT deficiencies, whether detected or apparent.

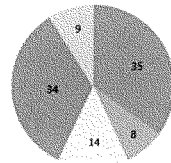


## Drivers of termination of end-customers by respondents

In per cent

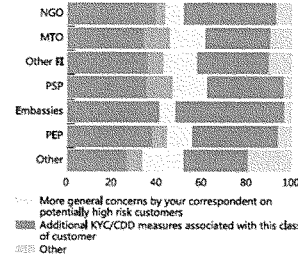
Graph 26

Drivers for terminations – All categories



■ Perceived risk  
 ■ An explicit requirement from one of your correspondent banks, as a condition for the continuation of the correspondent banking relationship

Drivers by category of end-customers



Answers provided by 118 banks. Other drivers mentioned are business strategy, suspected involvement in money laundering activities, lack of profitability, high risk jurisdiction, fraud and failure to comply. Other institutions reported are FX companies, brokerage firms, casinos, gambling related businesses, virtual currency-related entities.

Source: FSB-CBCG Survey

## De-risking of NPOs

Over the past several years, numerous reports document the consequences of financial access problems for de-risked communities, with most focusing on correspondent banking and, to a lesser extent, MSBs. While anecdotes concerning difficulties charities experience have been growing, there had been no solid data available concerning NPOs' problems accessing banking services, save for an indicative survey in 2014 of U.K. charities by the Charity Finance Group.

Moving beyond anecdotes, *Financial Access for U.S. Nonprofits*, released in February 2017 presented the first empirical data as to the scope and nature of problems NPOs encounter. The study was both qualitative and quantitative, including interviews and roundtables with all stakeholders – policymakers and regulators, financial institutions, and NPOs, as well as a random sample survey of U.S. NPOs, designed and conducted by the Schar School of Policy and Government at George Mason University (which entailed telephone interviews of 305 charities; findings were determined to be valid within a 5.4% margin of error).

The report's surprising results paint a picture of a far more pervasive problem than expected, affecting many kinds of NPOs operating in all parts of the globe.<sup>2</sup>

<sup>2</sup> See Appendix A for the Executive Summary and Data Highlights of the report, *Financial Access for U.S. Nonprofits*

Among the report's major findings:

- 2/3 of all U.S. nonprofits that work abroad are having financial access difficulties
- 15% of nonprofits report having these problems constantly or regularly
- Delays in wire transfers, which can last up to several months, are the most common problem, affecting 37% of nonprofits
- One-third of NPOs have experienced fee increases, and 26% have faced additional, unusual documentation requests
- Account closures represent 6% and refusal to open accounts 10% of NPOs, but often can have devastating effects
- Transfers to all parts of the globe are impacted; the problem is not limited to conflict zones or fragile and failing states
- Smaller NPOs, often the last mile in delivering essential assistance, are more likely to encounter delayed wire transfers, fee increases, and account closures
- When money cannot be transmitted in a timely manner, 42% of nonprofits resort to carrying cash and nearly 30% use money remitters

***The report concluded that international banking difficulties constitute a "serious and systemic challenge for the continued delivery of vital humanitarian and development assistance," a core component of U.S. foreign and security policies.***

As further evidence of the growing problem of NPO de-risking, a new study released in March of this year by the U.K. Charity Finance Group found that 79% of British charities face difficulty in accessing or using mainstream banking channels. The same number of respondents also said that banks had become "substantially or slightly more risk averse to them." Moreover, an increasing number of reports in the past several years document the problems and effects of limited financial access for NPOs.<sup>3</sup>

#### Essential role of NPOs and impacts of de-risking

The U.S. NPO sector is extremely diverse, ranging from large regional, national or international charities to small, community-based organizations offering a wide variety of programs and services. Research institutes, churches, and professional associations are among the many types of NPOs that typically depend, in whole or in part, on donations, dues or voluntary service for support. The IRS recognizes more than two dozen types of NPOs, with charities making up the largest category of exempt organizations.

The charitable sector provides essential services, complementing government initiatives to assist those in need, often in high risk areas, conflict zones, and inaccessible regions. NPOs' charitable activities help to meet vital humanitarian and development needs. The U.S. recognizes and supports the crucial role of charity in communities worldwide, and views provision of financial services to NPOs to be in the public interest and consistent with AML/CFT goals. Many NPOs, in fact, play critical roles in fighting conditions conducive to terrorism, reducing the appeal of

<sup>3</sup> See Appendix B for a list of reports related to NPOs and financial access challenges.

terrorism by building social structures and increasing intercommunity dialogue and understanding. Inadequate financial access and/or delayed transactions due to concerns for regulatory risk can undermine U.S. foreign and security policies.

Financial services are essential for NPOs to be able to operate safely, effectively and transparently. When NPOs are unable to access banking services, charitable funds may go underground, through increased cash transactions and off-shore cash couriers, or alternative remittance systems. The use of cash, particularly in higher-risk jurisdictions, creates safety concerns for NPOs and their staff and make it more difficult to ensure that funds reach the intended recipients.

There are also additional concerns that de-risking may result in increased flows of informal money. The U.K. reported circumstantial evidence that greater use of cash and other unconventional channels have resurged in some places as a possible consequence of de-risking of NPOs. AML/CFT objectives of transparency and traceability are undermined if financial transactions are driven outside of regulated channels into untraceable banking alternatives.

When NPOs are turned away as customers, have their accounts closed by financial institutions, or experience delays or denials of wire transfers, serious complications result for the delivery of critical humanitarian assistance to countries such as Syria, Somalia and other conflict areas. The 2016 *Study of the Humanitarian Impact of Syria-Related Unilateral Restrictive Measures* documented the “chilling effect” of the private sector’s reluctance to support humanitarian activity, particularly by the financial sector fearful of penalties for inadvertent regulatory violations.

Examples abound regarding deleterious impacts of financial access difficulties. One NPO sought to transfer \$2m from the US to UK to cover costs for a Syrian winterization project. It was delayed and ultimately denied after 6 months; the inability to transfer funds caused significant operational challenges across the global organization because of the shortfall in cash resulting, not to mention the broken trust and danger to staff created for the field office because they are in arrears with the vendors. In another case, a wire transfer (via Turkey for a hospital in Aleppo) was delayed by 6 months in spring 2017. By the time the transfer was processed, the siege was over. Lengthy delays in transmitting funds to pay for fuel to power a Syrian hospital reportedly resulted in the hospital running out of fuel, leading to severe health complications and suspected fatalities. Funds were denied for two clinics in Lebanon for Syrian refugees that ultimately resulted in the closure of the clinics. In Sudan, a license expired before funding for a Sudanese orphanage program was complete. The NPO was told to suspend operations pending renewal of the license, which took 5 years to approve food, shelter, and medical care at the orphanage. There have been instances where flights for UN food drops have been loaded and are grounded on the tarmac waiting for payments to be approved before being allowed to take-off, which could have a knock-on effect of endangering the awarding of future contracts to customers involved in UN activities.

Financial access problems have also created a chilling effect on donors and fundraising, increased compliance costs and challenges, and resulted in limitations on humanitarian assistance

programming, not based on need but rather on where banks will transfer funds. “Because of the possibility of serious delays or cancellation, we have to pick programs that will do least damage if operations are suspended. This excludes some of the most important programs related to development and assistance.” One NPO reluctantly decided it would no longer be able to support Sudanese orphans because of financial access-related issues: “In trying to prevent money laundering and terrorism finance, restrictions on sending money are resulting in the death of persons, particularly the victims of terrorism.” Moreover, the use by banks of commercial data providers such as World Check and Lexis Nexis to fulfil KYC and DD requirements has been highly problematic with these services producing a high number of false positives. Banks concede that there are deficiencies in these commercially available risk-profile databases.

At the same time NPOs’ abilities to access the financial system have been hampered, the level of humanitarian need worldwide has reached unprecedented levels. Violent conflicts, climate disasters, and political repression have generated the largest number of displaced persons since World War II. The UN Office of the Coordinator for Humanitarian Affairs (OCHA) reports more than 135 million people across the world will need humanitarian assistance and protection in 2018, an increase of 5% from 2017. Emergencies in Syria, Yemen, South Sudan, Iraq and Sudan, as well as long-term crises in Somalia, Pakistan, and elsewhere have increased the demand for humanitarian and development assistance, yet the very countries in most dire need of support are among those to which NPOs are having the greatest difficulties in receiving/transferring funds. Just last week, the United Nations reported that the number of hungry people in the world has risen for the first time in more than a decade, with approximately 38 million more undernourished people, rising to 815 million in 2016, the year for which the latest statistics are available. According to the 2018 UN Sustainable Development Goals report, conflict is now one of the main drivers of food insecurity in 18 countries.

#### Outdated perceptions of risk associated with NPOs

The problems many NPOs experience today stem from action taken in October 2001 by the FATF, whereby protection of the NPO sector from terrorist abuse became a component of the global fight against terrorism. In adopting Special Recommendation VIII (R8), FATF identified NPOs as “particularly vulnerable” to terrorist financing abuse, calling on countries to ensure that NPOs cannot be misused by terrorist organizations. Over time, however, the FATF refined its standard, acknowledging the changing threat environment and the development by the NPO sector of standards and initiatives to ensure accountability and transparency in their operations. In 2014 and 2015, FATF guidance explicitly stated that legitimate charitable activities should not be disrupted or discouraged, clarifying the subset of NPOs that required greater attention - NPOs engaged in service activities and operating “in a close proximity to an active terrorist threat.” FATF warned that:

“Financial institutions should also not view all NPOs as high risk. Most NPOs may face little, if any, risk of terrorist financing abuse. For example, financial institutions should not view NPOs as high risk simply because they may operate in cash-intensive environments or in countries of great humanitarian need.”

According to FATF, a “one size fits all” approach to NPOs, whether it comes to supervision and monitoring of NPOs, or how banks manage business relationships with NPO customers, is not appropriate.

Reflecting the decreased risk associated with NPOs, FATF revised R8 in 2016, recognizing that not all NPOs should be subject to the same measures, especially “where humanitarian needs are acute and where charitable work contributes positively to the fight against regional and global terrorism.” Subsequent national terrorist financing risk assessments also reflect the lower risk of abuse of NPOs. The U.K. National Terrorist Financing Risk Assessment noted:

“In comparison to the overall size of the UK charity sector, the amount of known abuse for terrorist financing is very low. It is unlikely that charities have been set up for the purpose of funding terrorism. As such, we now assess the risk of abuse of NPOs altogether for terrorist financing as low, with certain parts of the sector facing significantly higher risks.”

Similarly, the 2015 US risk assessment referenced sham or front organizations as the greatest threat to the nonprofit sector, rather than legitimate NPOs.

The outdated and overly broad view of the terrorist financing risks associated with the NPO sector persists, however, notwithstanding changes to FATF R8 to remove the “particularly vulnerable” language and call for a proportionate risk-based approach. In fact, most governments have not issued new regulatory guidance reflecting FATF’s revision of R8 or even national assessments of risks related to NPOs; only 1 country assessed by the FATF under the revised standard as of May 2018 was found to be compliant with Rec 8 - Canada.

Furthermore, there is a pervasive lack of understanding of the charitable sector in general, and unfamiliarity with the NPO business model. Many banks and regulatory officials are unaware of the risk assessment and due diligence measures NPOs routinely undertake, not only to comply with sanctions and CFT regulations, but also to account to donors and manage risks to operations and employees. The fact that NPOs are subject to a complex system of regulation and oversight at the federal, state and local levels, and required to register and be monitored by the IRS and state authorities is not well-understood. In addition to reporting requirements, many NPOs also adhere to voluntary self-regulatory standards and controls to improve individual governance, management and operational practice, beyond internal controls required by donors and others. These regimes primarily regulate raising, spending and accounting for funds, seek to protect the public from fraud, and encourage charitable giving. NPOs receiving federal grants undergo additional review by grant making agencies to comply with standards required by OMB (e.g. Agency for International Development recipients are subject to rigorous scrutiny, compliance, and independent auditing requirements).

Without change to the Bank Secrecy Act or the AML Bank Examination Manual or new U.S. regulatory guidance, it’s not surprising that financial institutions continue to consider NPOs categorically as high-risk, a view reinforced by examiners. International transfers to certain countries (those subject to sanctions) are viewed with extreme caution: numerous NPOs report

that any request involving a reference to Syria (e.g. assistance destined to Syrian refugees in Turkey or Lebanon) has become a red flag, even for NPOs that have secured necessary government approval or licensing for such activities. Several charities aiding Syria report wire transfers being denied and even closure of their bank accounts.

To reassure banks, government officials have issued statements noting that the charitable sector as a whole, does not present a uniform or unacceptably high risk of money laundering, terrorist financing or sanctions violations. In the U.S., policymakers urged banks to apply due diligence obligations reasonably, “not that they be infallible in doing so”. However, the fact that there have been no changes to regulations or guidance to encourage financial institutions to update their risk assessments of NPOs ensures that de-risking of NPOs will continue. Without action by government, financial institutions will continue to be reluctant to bank NPOs.

#### Responses to date

As de-risking is an international phenomenon, various governments have attempted to address concerns of NPOs in a variety of ways over the past several years. In cases of sanctions, the U.S. has amended general licenses for NPOs engaging in humanitarian activities (e.g. Syria, Somalia, and Sudan). Within the European Union, the Syria regulation and FAQs have been issued to clarify the applicable legal framework and encourage the reliance on the humanitarian derogations in the Syria autonomous sanctions. These measures relate to licenses to facilitate the delivery of aid, but do not address bank payments specifically.

Of particular note, however, over the past year and half, multi-stakeholder initiatives have been organized to bring together government, financial institutions, and charities to address the serious effects NPOs have experienced. These initiatives are relatively recent and while encouraging, results have been limited to date.

In 2016, the World Bank and ACAMS (Association of Certified Anti-Money Laundering Specialists) convened the *Stakeholder Dialogue on De-Risking* with more than 100 participants from government (policy, regulatory, and law enforcement authorities), international organizations, financial institutions, and NPOs to discuss the phenomena of de-risking and how to address it. Until then, most de-risking discussions had focused primarily on challenges of correspondent banks and MSBs, but the dialogue noted the significant difficulties humanitarian organizations and charities were experiencing with financial access.

In recognition of the importance of supporting critical humanitarian and development work globally, the World Bank/ACAMS organized a second Dialogue (*Supporting Financial Access for Humanitarian Organization and Charities*) in January 2017 to foster relationships between NPOs, financial institutions, and government; improve the regulatory and policy environment; and develop tools to facilitate understanding and information-sharing. As a result, four workstreams were organized and initiatives are ongoing to:

- provide guidance regarding the type of information banks require to conduct due diligence on NPO customers, and develop training programs/resources;

- propose amendment of the Bank Examination Manual to implement FATF R8, consider options for specialized payment channels for humanitarian crises when the traditional banking is unable to move funds, and explore improvements in humanitarian licensing and exemptions;
- explore technological solutions to facilitate NPO access to financial services, particularly transfers to areas of higher risk and help lower the cost of compliance with CDD requirements in banking NPOs (e.g. NPO KYC utility), and
- promote greater understanding of NPOs and broader financial access challenges through online resources and outreach

A further World Bank/ACAMS stakeholder meeting took place in Washington, DC in mid-June to discuss the lack of progress in addressing financial access problems, while NPOs' difficulties appear to be worsening.

In addition, and in partnership with the Dutch Ministry of Foreign Affairs and the Human Security Collective (HSC), the World Bank/ACAMS convened an *International Stakeholder Dialogue: Ensuring Financial Services for Non-Profit Organizations* in The Hague in February 2018 to discuss comparative approaches to the NPO de-risking challenges.

Multi-stakeholder dialogues have also taken place in the Netherlands and the United Kingdom. In October 2017, the Human Security Collective hosted a session to discuss the financial access experiences of Dutch NGOs, the requirements on and concerns of financial institutions, and perspectives of the Ministries of Finance and Foreign Affairs. The meeting was the first in a series to explore possible solutions for stakeholders. Dutch stakeholders appear interested in identifying tailor-made solutions for different types of NPOs. In the U.K., various initiatives by UK Finance (formerly the British Bankers Association) and the Disasters Emergency Committee (DEC) over the past several years have attempted to address aspects of financial access problems of NPOs, especially concerning humanitarian aid to Syria with limited success. A British multi-stakeholder initiative has been meeting since late 2017 to address problems and operating risks facing INGOs in high-risk contexts, such as Syria and Somalia where the delivery of essential humanitarian assistance and development and peacebuilding activities are challenging. Three sub-groups working on the topics of Guidance and Legislation, Training and Best Practices, and Innovation and Information Sharing (including technological solutions) are exploring possible solutions.

#### Potential solutions

While multi-stakeholder initiatives are in the early phases of developing possible solutions, financial access problems continue, and for some, appear to be worsening. These multifaceted problems arise as a result of multiple but equally compelling policy objectives – to protect security and the integrity of the global financial system from illicit finance and counter terrorism, and to advance foreign policy goals of development, democracy and humanitarianism by providing aid to people in need.

To effectively address the challenges of financial access, all stakeholders must work together in a concerted manner; viable solutions will be found only when the problems are viewed as a shared responsibility of all. There is no single clear-cut solution that will resolve such a complex issue but rather a series of issues that need to be investigated in multi-stakeholder settings. Following are general categories of actions that could usefully be explored but is by no means complete.

#### Raise awareness and promote a balanced approach

To enhance understanding by banks and governments of NPOs, and by NPOs of regulatory requirements and expectations, enhanced engagement and interaction among all stakeholders is necessary. All stakeholders must recognize humanitarian and development assistance as a priority and take steps to work together for a shared view that ensures balance between mitigating sanctions and terrorist financing risks and facilitating the movement of funds necessary to deliver vital assistance.

Some financial institutions have made special efforts to bank charitable groups operating in sanctioned countries, developing specific guidance. Likewise, many NPOs have adopted self-regulatory measures to ensure accountability, effective control, and transparency in their operations. Sharing information about risk mitigation procedures can help to build mutual confidence and understanding that may reduce questions and problems with financial transactions. NPOs and banks should deepen their engagement with one another, and governments should take a leadership role at national and international levels in seeking solutions. Consideration should be given to raising the issue systematically within other multilateral fora such as the G20.

#### Provide regulatory and policy guidance

Governments should develop policy and regulatory guidance that provides greater clarity to banks and NPOs on the implementation of the risk-based and proportional framework. Statements that NPOs are not by definition high-risk customers are helpful but insufficient to change financial institutions' willingness to bank NPOs. Revision of the BSA-AML Manual to implement FATF Rec 8 is necessary for financial institutions to change their outdated but persistent perception of NPOs as inherently high risk and to effectively implement a risk-based approach to banking charities. As part of the World Bank/ACAMS initiative, banks and NPOs jointly developed a proposal to revise the existing manual, a testament to the potential of multi-stakeholder strategies. The proposal is currently pending review by regulatory agencies.

Development of better guidance and risk tolerance standards so banks have a clear understanding of regulatory expectations concerning due diligence are important. Guidance and standards must be consistent, practical, relevant to today's financial services market, and proportionate to any actual risk identified, and implemented by examiners. They should clearly outline what information is required to ensure legal compliance by both banks and NPOs while remaining flexible enough to adapt to various types of financial institution and NPO customers. This can lower compliance costs, differentiate between different levels of risk and focus scarce resources on reducing real risks.



#### Explore incentives for financial institutions to bank NPOs

A menu of measures, including the creation of a safe harbor to incentivize banks to keep NPOs accounts and encourage efforts to engage with NPOs, should be developed. Monetary incentives, such as tax credits, reputational incentives, or recognition of financial institutions who engage in—rather than avoid—effective risk management of NPOs could be explored. A mechanism for NPOs to pool accounts might also provide incentives for banks by streamlining administration and lowering costs.

Measures whereby financial institutions that bank NPOs in good faith and meet certain criteria would be held harmless if funds inadvertently end up in the wrong hands should be considered. The miniscule risk that funds are mislaid is outweighed by the need to ensure that aid is delivered to conflict areas in order to build resilience against terrorism. Safe harbor measures would provide banks confidence that they can do business with NPO customers if they maintain rigorous risk-mitigation and internal compliance controls. Various formulations could be developed on a trial basis, such as temporary waivers of sanctions enforcement, reduced penalties, and limited relief from regulatory actions for all but egregious willful violations. Moreover, if governments fund an NPO's projects, banks should be able to rely on such approval as adequate customer due diligence, since the extensive governance and reporting requirements that most government grantees must meet make additional customer due diligence by banks duplicative and unnecessary.

#### Create safe payment channels

When the international financial system is not able to meet the needs of NPO customers doing humanitarian work, new and special procedures to facilitate the transfer of funds into conflict areas may be needed. Thoughtful options to create safe banking and payment channels into high risk jurisdictions have been advanced, with most attention focused on ways to move international humanitarian funds into Syria. In the absence of a political resolution to the conflict, potential solutions are likely to include identification of private banks approved to receive humanitarian-related funds. While a range of options to develop a safe payment corridor are under discussion, all are complicated in terms ensuring compliance with sanctions and preventing diversion. Such efforts require concerted efforts by like-minded governments and regulators, banks and NPOs, and international organizations, and are likely the only option to provide humanitarian assistance to conflict areas where need is greatest but where banks will not go without such assurances.

For NPOs who have lost their bank accounts but are providing services supported by governments, a public entity, such as a central bank or regional development bank might facilitate the movement of funds into high risk areas on an emergency basis. It is important to recognize, however, that in some humanitarian crises, reliable documentation and ordinary due diligence required of NPOs are likely to be unrealistic, given unique local conditions. Alternative

ways to avoid inadvertent support to designated groups could be explored but ultimately there is no “fail safe” solution in transferring funds into some environments. Developing shared views of which destinations and characteristics are acceptable and a shared responsibility are necessary to deal with crises.

#### Improve humanitarian licensing and exemptions

Sanctions have increased in number and scope, and include multilateral UN measures, regional EU sanctions, and unilateral measures by the US and other countries. These sanctions have had significant impacts on the ability of many NPO to operate, with licenses often requiring months to process. Suggestions to improve licensing of humanitarian relief efforts and the payments needed to carry them out should be explored.

While the Office of Foreign Assets Control (OFAC) utilizes general licenses (whereby no prior approval is necessary if certain conditions are met) to implement humanitarian exemptions from sanctions for countries such as Syria, other countries need to develop more flexible approaches to facilitate humanitarian assistance. The mutual recognition of licenses granted by other countries could also be explored.

To promote more flexible licensing, United Nations Security Council sanctions resolutions should routinely include humanitarian exemptions (UNSCR 2317 concerning Somalia is the only sanctions regime that has adopted a humanitarian exemption) or a standing humanitarian exemption should be adopted by the Security Council.

#### Explore Technological Solutions to Facilitate NPO Transfers

With new payments platforms, innovative technologies have emerged that could increase efficiency and reduce compliance burdens associated with banking NPOs. Technological options to enhance transparency and information sharing capabilities such as KYC utilities, e-credits, and legal entity identifiers could help promote NPOs transfers and lower the cost of CDD compliance in banking NPOs. The World Bank/ACAMS process is exploring the parameters for a repository/utility containing comprehensive information on NPOs.

#### Provide capacity assistance

The complexity of AML/CFT/sanctions policies has increased substantially, and many countries and their stakeholders lack resources to effectively implement regulatory requirements. Some countries assert that their inability to train regulators, banks and affected communities such as NPOs, in implementation may exacerbate de-risking. Capacity building assistance is needed in numerous countries to explain regulatory requirements and compliance obligations to stakeholders.

#### Concluding Thoughts

The scope, severity and effects of narrowing financial access for U.S. NPOs is alarming. The fact that 2/3 of NPOs face difficulties with international financial transactions, and that 37% experience delays of wire transfers is a cause for alarm, especially as the situation appears to be worsening. These problems affect many different types of organizations and programs in all parts of the world, indicating a systemic problem. The resulting harm whereby people needlessly suffer from starvation, disease, terrorism and conflict, is tragic and unacceptable.

The underlying AML/CFT/sanctions policies related to the de-risking phenomena are valid and critical security objectives, but the damaging unintended consequences of these policies threaten to undermine vital U.S. interests. A commitment of all stakeholders—U.S. policymakers and regulators, financial institutions and nonprofits—to the shared responsibility of finding solutions to the financial access problems of NPOs is necessary to address this growing crisis. Without acknowledging the deleterious humanitarian consequences of restricted financial access for NPOs, as well as concerted action to address it, the situation will continue unabated, undermining U.S. foreign and security policies. US leadership on this critical issue is necessary.

## Biography

Sue E. Eckert

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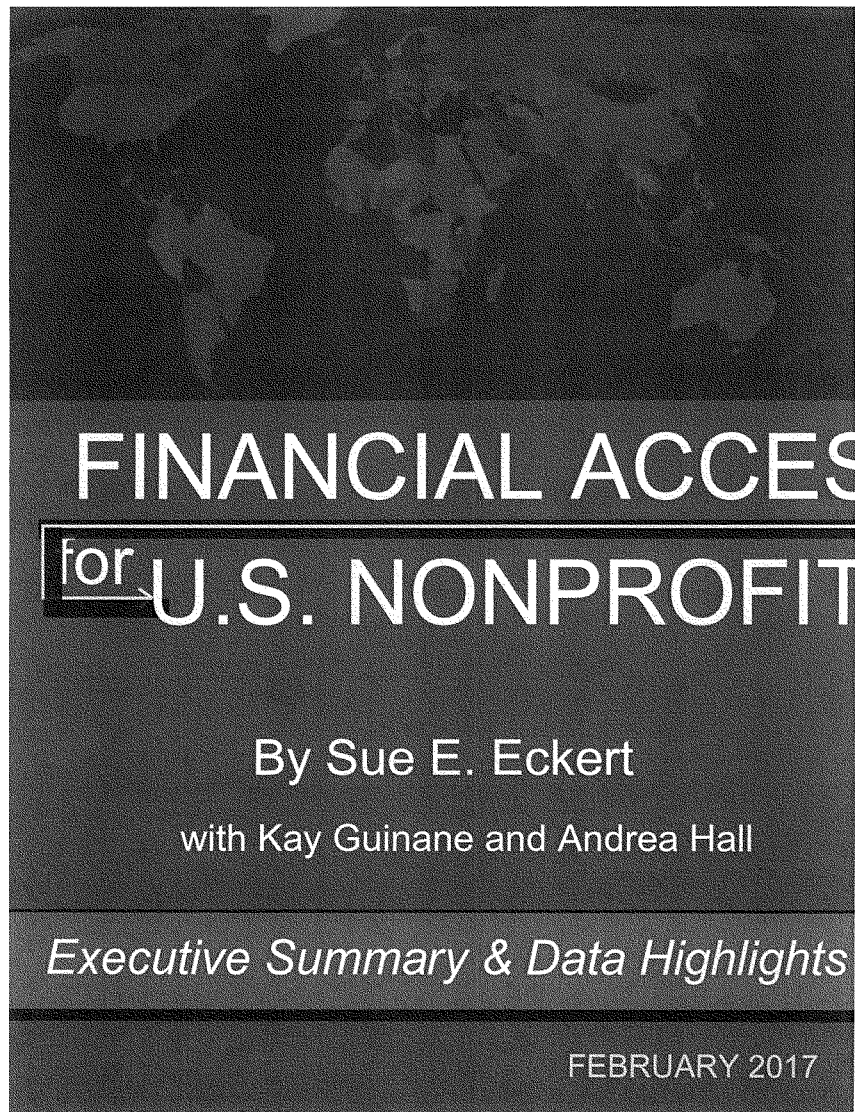
The Honorable Sue E. Eckert is an Adjunct Senior Fellow at the Center for a New American Security, where she focuses on issues at the intersection of economics and national security. Research interests include economic statecraft, sanctions, terrorism and proliferation financing, and cybersecurity. She also is an adjunct professor of law at Case Western Reserve Law School, teaching in the first master's degree program in financial integrity.

She was appointed by President Clinton and confirmed by the U.S. Senate as Assistant Secretary of Commerce for Export Administration (1993-1997), responsible for dual-use export control policy and defense industrial base programs. Previously, she was a member of the professional staff of the U.S. House of Representative's Committee on Foreign Affairs, where she oversaw national security/nonproliferation, international trade, and technology transfer issues.

From 1998-2016, Ms. Eckert was Senior Fellow at Brown University's Watson Institute for International and Public Affairs where she directed projects on U.N. targeted sanctions, terrorist financing, and economic security. Recent publications include: *Financial Access for U.S. Nonprofits* (2017); *Targeted Sanctions: The Impacts and Effectiveness of UN Action* (2016, Cambridge University Press); *The Compendium of the High Level Review of UN Sanctions* (resulting from the 2014-15 initiative supported by five Member States and led by Ms. Eckert and colleagues to strengthen the implementation of U.N. sanctions); and the "The Role of Sanctions" in *The UN Security Council in the 21<sup>st</sup> Century*. She also collaborates with the U.S. Naval War College, hosting biannual cybersecurity workshops and forming a new political economy of security initiative of scholars.

She co-lead an international research initiative (*Targeted Sanctions Consortium*) of more than 50 scholars and practitioners examining the impacts and effectiveness of United Nations targeted sanctions, resulting in the creation of two new databases and a new online tool, *SanctionsApp*. Working extensively with national governments and U.N. bodies to enhance instruments of collective security, Ms. Eckert co-authored *Targeted Financial Sanctions: A Manual for Design and Implementation* and the series of "Watson Reports" to address due process concerns in sanctions designations, participated in multilateral initiatives (the Interlaken, Bonn-Berlin, and Stockholm Processes), and organized workshops, simulations, and training for the Security Council and Member States, among others.

Ms. Eckert has served as a consultant and member of numerous working groups and committees addressing security and technology issues, including the National Academy of Sciences Committee on Deterring Cyberattacks, and the Resource Group advising the United Nations High-Level Panel on Threats, Challenges, and Change. She has testified before the U.S. Congress and Canadian Parliament, United Nations, and European committees, participated in numerous other international fora and is a frequent commentator on international security issues.





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## EXECUTIVE SUMMARY

In response to the September 11, 2001 attacks on the United States, the regime to deny terrorists and criminals access to the global financial system has significantly expanded. Financial institutions (FIs), the lynchpin of the system, are required to employ a "risk-based approach" to assess their money laundering and terrorist financing (ML/TF) vulnerabilities, know their customers, and implement compliance programs to manage and mitigate situations of higher risk.

Over time, a number of factors, including anti-money laundering (AML) and countering the financing of terrorism (CFT) regulatory obligations and oversight of FIs, have led to the phenomenon of "derisking." This refers to the trend of financial institutions terminating or restricting business relationships to avoid rather than manage risk. The most frequently mentioned driver of derisking, as cited by FIs, is the concern for running afoul of regulatory requirements.

There are costly consequences of derisking for a variety of sectors, including nonprofit organizations (NPOs). In particular, examples have come to light of lifesaving assistance stymied as a result of charities' inability to transfer funds to foreign countries, including humanitarian disasters in Syria, Somalia and other conflict areas. Banks under pressure to comply with AML/ CFT regulatory expectations and sanctions have delayed or denied financial transfers and closed accounts, complicating efforts by charities and humanitarian groups trying to deliver aid.

*Until now, there have been no data indicating the scope and type of difficulties U.S. NPOs might be experiencing.* This research initiative, commissioned by the Charity & Security Network and supported by the Bill and Melinda Gates Foundation, was undertaken to develop empirical data to inform the policy discussions concerning derisking and financial access.

*With this report, the question as to whether financial access is a problem for NPOs has now been answered: it definitively is.* Years of anecdotal evidence reported by NPOs regarding difficulties with financial services are now confirmed through a random sample survey of U.S. nonprofits, using Internal Revenue Service data on public charities that do international work (NPOs).

### Survey Results Show There is a Systemic Problem

This report presents empirical data from the random sample survey undertaken for this study. The findings are valid within a 5.4% margin of error. The results paint a picture of significant problems, affecting many kinds of NPOs operating in all parts of the globe. Highlights of the survey findings are below:

#### *Characteristics of U.S. NPOs Working Internationally*

- There are 8,665 U.S. NPOs operating abroad (based on IRS data).
- They work in a range of sectors, including education, development/poverty reduction, humanitarian relief, public health, medical services, human rights/democracy building and peace operations/peace building, among others.
- 45% of all U.S. NPOs engage in humanitarian relief work.
- Most NPOs are relatively small (median revenues of \$1.5 million and expenditures of \$1 million), but almost half of them (48%) are large enough to operate a branch or field office abroad.

#### *Financial Access Problems*

- 2/3 of U.S.-based NPOs working internationally experience banking problems.
- The most common problems include: delays of wire transfers (37%), unusual documentation requests (26%), and increased fees (33%). Account closures represent 6% and refusal to open accounts 10%.
  - 15% encounter these problems constantly or regularly.
- The prevalence and types of problems vary by program area, with NPOs working in peace operations/peacebuilding, public health, development/poverty reduction, human rights/democracy building, and humanitarian relief reporting the greatest difficulties.
- Transfers to all parts of the globe are impacted; the problem is not limited to conflict zones or fragile and failing states.
- NPOs with 500 or fewer staff are more likely to encounter delayed wire transfers, fee increases, and account closures. Most significantly, smaller organizations are almost twice as likely to receive unusual additional documentation requests. The smallest NPOs (those with 10 or fewer employees) are having the most trouble opening accounts.
- NPOs, categorically treated as high-risk, are sometimes forced to move money through less transparent, traceable, and safe channels as a result of delays in wire transfers and requests for additional documentation.

The scope of the problem, which affects 2/3 of U.S. NPOs and programs in all parts of the world, constitutes a serious and systemic challenge for the continued delivery of vital humanitarian and development assistance – a core component of American foreign and



security policies. As a result, financial access for NPOs must be recognized as a barrier that needs to be addressed on par with correspondent (intermediary) banking and money service businesses (MSBs). It is time to move beyond discussions of whether there is a problem, arguments over definitions, and the finger-pointing that have characterized the issue to date. Now is the time to seek solutions.

As NPOs' ability to access the financial system has been hampered, the level of humanitarian need worldwide has reached all-time highs. Refugees fleeing war, climate disasters and political repression have generated the largest number of displaced people since World War II, making the programs U.S. NPOs operate in other countries more important in saving lives and preventing the further erosion of democracy and human rights.

### **The Drivers of Narrowing Financial Access for NPOs Are Complex**

There is no simple or singular reason for derisking generally or of NPOs specifically, and this study does not contend that all decisions by FIs to terminate NPO accounts or delay wire transfers are attributable exclusively to AML/CFT concerns. However, interviews for this report, as well as regular surveying of the financial industry, consistently demonstrate that FIs' compliance-related concerns and regulatory expectations are among the most significant reasons for derisking. A multiplicity of factors has indeed created a "perfect storm" resulting in serious unintended consequences which limit financial access for NPOs.

For many FIs, decisions to withdraw or decline to provide financial services involve customers perceived to be higher-risk, such as NPOs, and higher-risk jurisdictions (often the countries where humanitarian assistance and development NPOs work). Routine second-guessing of FIs' decisions and treatment of certain clients as categorically high risk by bank examiners require FIs to undertake extensive and expensive steps to mitigate those risks, tipping the risk-reward scale toward exiting such relationships. Despite reassuring statements from government officials, FIs perceive a clear disconnect between what policy officials say and what happens at the individual bank examination level.

### **Action Is Needed**

To effectively address the problems of derisking/financial access, all stakeholders must work together in a concerted effort. Solutions will only be found if the problem is approached as a shared responsibility. Policymakers' characterizations of these issues as solely "commercial decisions" ignores reality and is a recipe for continued derisking and all of its consequences.

There has been little recognition by U.S. officials that financial access is a problem for NPOs, in contrast to the public acknowledgement of derisking in the context of correspondent banking and MSBs. U.S. policymakers and regulators appear reluctant to take NPOs' concerns seriously or to address these issues. Skepticism, along with long-held attitudes that the NPO

sector is high-risk, pervades many discussions, from the policy levels down to individual bank examiners. FIs are likewise reluctant to devote resources to address issues regulators do not treat as a priority.

The result is a clear lack of leadership and accountability on derisking issues, as noted in previous reports. Government points to the private sector, banks point at regulators, and NPOs are frustrated and left without financial services. A recent dialogue initiated by the World Bank and Association of Certified Anti-Money Laundering Specialists (ACAMS) shows promise in bringing stakeholders together.

All parties would benefit from solutions to these financial access issues, but the associated cost makes it unlikely that any individual group can or will undertake them alone. The ideal solution is therefore, collective action, the cost of which is shared. Leadership from policymakers and regulators is necessary, starting with acknowledgment of the seriousness of the issue, and moving to action to clarify regulatory expectations and articulate a coherent policy.

### **Inaction is Costly**

Importantly, the human costs of NPOs' financial access difficulties and continued inaction must be recognized. When programs are delayed or cancelled because of the inability to transfer funds, peace is not brokered, children are not schooled, staff is not paid, hospitals lose power, the needs of refugees are not met and in the worst cases, people die. Maintaining current policies in the face of evidence of the negative humanitarian consequences is not only harmful but inconsistent with American values.

There are multiple interests at stake in the derisking crisis. In this context, broader foreign policy and security concerns appear to be underappreciated. The goals of financial inclusion and financial integrity have been characterized as incompatible, but both can be achieved. Ironically, current policy has created consequences that increase the risk of illicit finance. Because these problems are not being effectively managed, U.S. policy objectives of development, humanitarian assistance, and even countering terrorism and violent extremism are negatively impacted.

Protection of the global financial system from abuse by criminal and terrorist organizations has been and will continue to be an essential element of U.S. national security policy. A key component of multilateral counterterrorism/countering violent extremism (P/CVE) initiatives is the ability of civil society organizations to engage and support local populations where terrorism takes root. NPOs play a vital role in this effort.

The U.S. government process to address financial access issues, however, remains heavily weighted to illicit finance concerns, with the range of other agencies and interests not playing a commensurate role. Ultimately, even AML/CFT objectives are not promoted when financial

access of NPOs is restricted. Excessive regulatory expectations and enforcement are pushing more money into opaque channels where it is more likely to fall into the wrong hands. Fear of compliance failures results in a vacuum that is likely to be filled by less transparent and accountable financial institutions, undermining the integrity of the global financial system and U.S. security.

## Recommendations

There are several promising avenues for stakeholders to explore. The recommendations and options discussed in this report should be viewed as the starting point in a process that moves toward solutions and in no way do they exclude additional ideas that emerge from further consideration of the problem. However, in order to be effective, solutions must meet these basic criteria:

- Address the drivers of narrowing financial access for NPOs
- Adapt to all sizes of NPOs and FIs
- Improve the implementation of the risk-based approach to AML/CFT programs
- Avoid anything that would make compliance more complex and burdensome

**This report recommends the following:**

### ***Launch a Solutions-Oriented Multi-Stakeholder Dialogue***

There is an urgent need for all stakeholders to collaboratively review the existing illicit finance system and the policies designed to prevent it, and work to address the serious and systemic problems hindering financial access for U.S. nonprofits. For that reason, this report's top recommendation is for a multi-stakeholder dialogue to work towards solutions to NPO financial access problems.

### ***Update the Bank Examination Manual and Bank Examiner Training***

As enforcers of the Bank Secrecy Act with the ability to impose civil fines, Federal Bank Examiners are key to regulatory oversight and significantly influence FI behavior. As this report reveals, their work is often intrusive, second-guessing FIs' due diligence procedures and applying pressure that increases compliance costs and discourages FIs from serving their NPO customers. In addition, regulatory oversight often varies by examiner and the inconsistency adds to FI uncertainty. As suggested by multiple FIs interviewed for this report, a program is needed to re-train examiners to bring them up to date on the risk-based and proportionate framework, to create consistency between FI examinations, and to emphasize that NPOs are not by definition high-risk customers.

The NPO section of the Bank Examination Manual has not been updated to reflect the June 2016 changes in the Financial Action Task Force's Recommendation 8. A collaborative effort between FIs, NPOs and the Federal Financial Institution Examination Council is needed to

remove outdated language concerning risk assessment of NPOs. The resulting revision should guide FIs through a proportionate risk-based approach.

***Create an NPO Repository/Utility to Streamline FI Customer Due Diligence***

Technology-based solutions that enable effective and proportionate FI compliance, often referred to as “utilities,” can tackle much of the paperwork and oversight that results in rising compliance costs and hence, restricted financial access for NPOs. These utilities can eliminate much of the burdensome and duplicative documentation requests cited by numerous focus group participants. One proposal calls for a repository created specifically for NPO financial access purposes that would set out customized criteria that allow all types of organizations—large and small, established and new, secular and religious—to be included. FIs could then use the repository to collect information for their customer due diligence, obtaining it quickly and inexpensively. Using existing models as a guide, a team of lawyers and financial industry experts would evaluate the information submitted by NPOs.

***Create a Special Banking Channel for Humanitarian Crises***

As discussed in Chapter 7 of this report, the most profound and perhaps devastating impact of NPOs’ financial access problems is the loss of humanitarian programming. When the international financial system is not able to meet the needs of NPO customers doing humanitarian work, new and special procedures to facilitate the transfer of funds overseas may be needed. Given the dire humanitarian need in places like Syria, it is even more important that fund transfers are timely and that NPOs have access to bank accounts. Although special procedures would not address the systemic problem revealed by this study, they could alleviate some of the most dangerous and serious impacts.

***Institute Safe Harbor Protections***

The World Bank/ACAMs dialogue suggested the creation of safe-harbor provisions, whereby FIs that bank NPOs in good faith and meet certain criteria would be held harmless if funds inadvertently ended up in the wrong hands. Adopting a safe harbor would give U.S. banks confidence that they can do business with higher-risk customers and regions provided they maintain rigorous risk-mitigation controls that are recognized by regulators. Investment in consistent and effective due diligence procedures would lessen the threat of prosecution or regulatory enforcement, or at a minimum, cap penalties at nominal amounts. This approach could be highly effective in expanding financial access for NPOs.

***Improve Implementation of the Risk-based Approach***

FATF has updated its risk-based approach to make it proportionate and ensure that it does not negatively impact the work of legitimate NPOs. This framework is focused on effectiveness, and is relatively new. In particular, the notion of residual risk acceptance, inherent in the risk-based approach, is not always reflected in current rules or enforcement policies. As the FATF noted in its 2016 mutual evaluation of the U.S., terrorist financing and sanctions violations “are strict liability offenses.” There is an inherent tension between strict liability and a risk-based

approach that appears to contribute to narrowing financial access for NPOs. Steps to improve implementation of the risk-based approach include:

- Counter the outdated portrayal of NPOs as “particularly vulnerable” to terrorist abuse by incorporating the FATF’s revised Recommendation 8’s risk-based, proportionate approach into relevant rules and guidance, such as the Bank Examination Manual.
- Develop clear guidance and standards to reduce guesswork and compliance costs so that they outline what information is required to ensure legal compliance by both banks and NPOs.
- Promote transparency, information sharing and proportionality to recalibrate risk perception so that fear of harsh penalties for inadvertent violations does not drive FI risk assessment. Give credit for measures taken in good faith.
- Create incentives to encourage appropriate risk management so that FIs will not avoid NPOs as customers.

#### ***Explore Alternatives to the Formal Banking System***

In cases where formal financial transfers remain problematic, U.S. and international organizations could identify appropriate informal payment channels that NPOs can utilize to help lessen reliance on carrying cash. Alternative methods of moving funds, such as Bitcoin and other virtual currencies, mobile money, and new electronic payment systems, should be explored.

#### **Impractical Options**

The findings in this report are likely to generate other ideas for increasing financial access for nonprofits that merit further consideration. At the same time, however, some ideas have been proposed which, upon examination, were found to be unworkable for a variety of reasons. Others have been attempted without success. This report suggests that government sponsored “white lists” of approved NPOs, appeals to FI social responsibility programs, or NPO-focused efforts to build relationships with local bank managers are either unlikely to effectively address the NPOs’ financial access difficulties or have the potential to create additional problems.

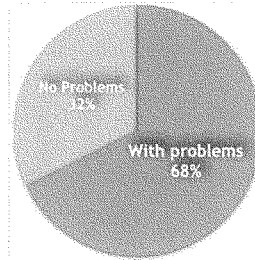
## DATA HIGHLIGHTS

Following are select figures and tables from the complete report, highlighting the most important data findings.

To read the full report, go to  
[www.charityandsecurity.org/FinAccessReport](http://www.charityandsecurity.org/FinAccessReport)

### Scope of NPO Financial Access Problems

A significant proportion (2/3) of NPOs that conduct international work are experiencing obstacles in accessing financial services.



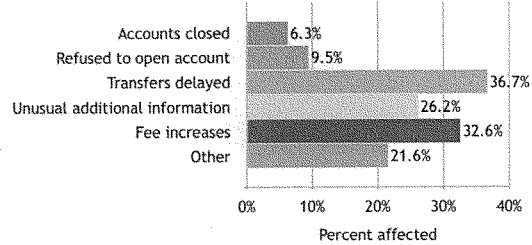
### Frequency of Financial Access Problems

Frequency of financial access problems	Total organizations (percent)	Total organizations likely impacted
Constant	5.4	468
Regular	9.7	841
Occasional	31.2	2,703
Rare	21.5	1,863
Never	32.2	2,790
TOTAL	100.0	8,665

Over 15% of NPOs encounter these financial problems constantly or regularly, with another 31% reporting occasional problems.

The two most common problems encountered by NPOs are delayed wire transfers and increased fees. Although account closures are less common than transfer delays, they can have an extraordinary impact.

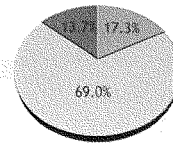
### Prevalence of Financial Access Problems\*



\*Percentages do not total 100% because survey respondents were allowed to give more than one response.

### Perception of Change in Severity

Overall, financial access problems for NPOs are not improving. 69% of NPOs surveyed report that the problem has stayed the same, while approximately 13.7% say it is getting worse.



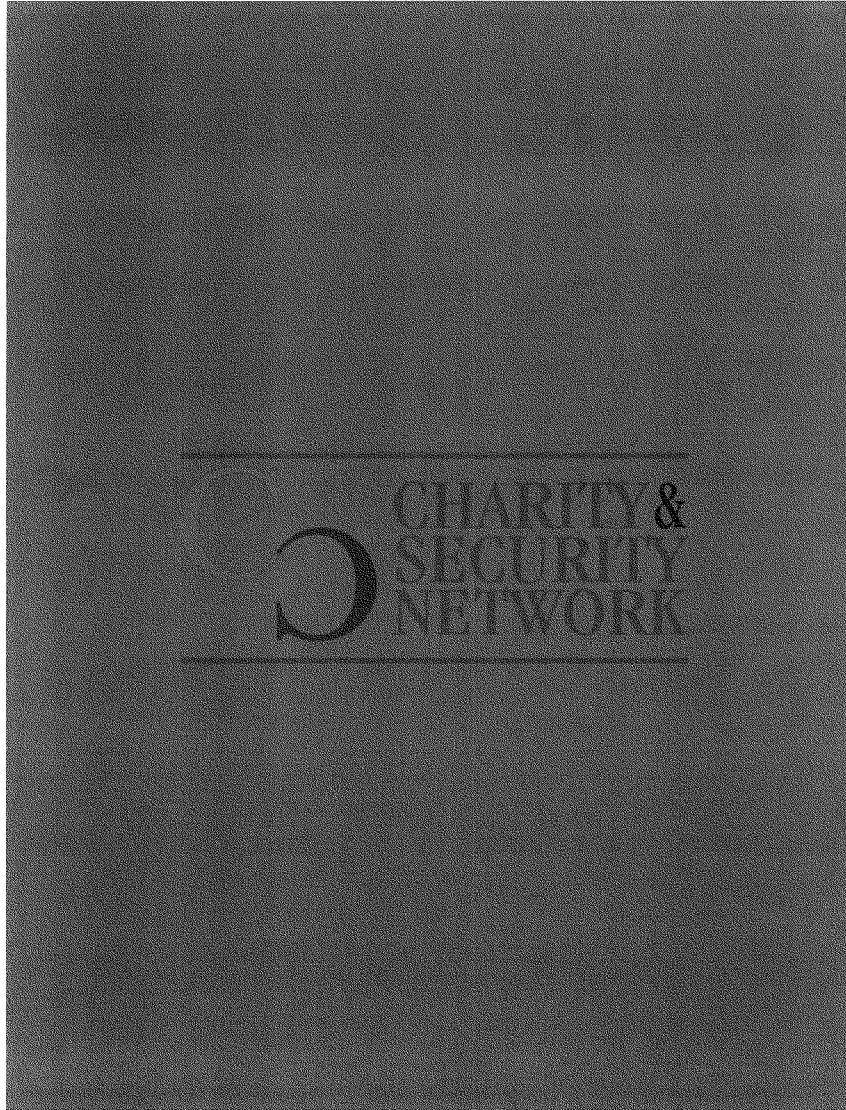
● Better ● Stayed the Same ● Worse

NPOs utilize a variety of strategies to cope with financial access problems, some of which put the safety of their staff and the integrity of the financial system at risk. Of significant concern is the data indicating that 42% of NPOs resort to carrying or sending cash when traditional banking channels become unavailable.

### Strategies Used to Address Problems\*

Strategies	Percent of NPOs Utilizing
Carry cash	41.7
Cancel the program	3.4
Find another financial institution	36.5
Use money remitter (Western Union or similar)	29.4
Performed a transaction successfully later	67.2
Other	24.9

\*Percentages do not total 100% because survey respondents were allowed to give more than one response.





## Appendix B: NPO Financial Access-Related Reports

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**Gabrielle A. Haddad**

**Co-Founder & Chief Operating Officer**

Testimony before the

**House Financial Services Subcommittee on Financial Institutions and Consumer Credit**

in a hearing on the

**“International and Domestic Implications of De-Risking”**

June 26, 2018

Chairman Luetkemeyer, Ranking Member Clay and distinguished Members of the House Financial Services Subcommittee on Financial Institutions and Consumer Credit. I am honored by your invitation to testify before you today.

De-risking is a phenomenon that has had dramatic impacts on the international financial system over the last decade. The practice of “de-risking” can take several forms. These forms include: the closure of bank accounts for certain high risk individuals and companies, the termination of correspondent banking relationships in high risk markets and the restriction of banking services to money service businesses and remittance firms. These practices have impacted the concentration of trade flows and cross-border payment activity, which challenges financial stability and inclusion for affected markets. For the United States specifically, a decline in dollar-denominated transactions and flows through U.S. financial institutions has potential implications on commerce, as well as, the United States’ competitive position.

I am the Co-Founder and Chief Operating Officer of Sigma Ratings, a company founded to address de-risking by highlighting and incentivizing good corporate behavior globally. I began my career as an attorney at a global law firm and subsequently spent several years as in-house counsel at a development finance institution, working in over 30 countries across Africa, Asia and the Middle East. Today, my testimony will focus on the international impacts of de-risking that resulted from the termination of correspondent banking relationships.

#### **The Role of Correspondent Banking in the International Financial System**

A correspondent banking arrangement involves one bank – typically a global bank referred to as the “correspondent bank” – providing a deposit account or other liability account, and related services, to another bank – typically an emerging or frontier market bank referred to as the “respondent bank”. The arrangement allows for transactions to be settled between the correspondent and respondent bank.

Respondent banks utilize their correspondent banking relationships to provide a range of services such as cash management, trade services, and foreign exchange to a variety of customers that include individuals, corporations, governments and other financial institutions. Correspondent

banking relationships also support the channeling of small payments or remittance flows on which emerging economies are reliant.

The IMF estimates that U.S. dollars account for about 50 percent of correspondent banking transactions<sup>1</sup>, making U.S. dollar correspondent banking relationships critical for access to the global financial system and U.S. banking regulation at the center of the de-risking discussion.

### **Drivers of De-Risking**

There are many drivers of de-risking, including profitability and reputational risk concerns, and these drivers may vary from country to country. However, fears of regulatory enforcement actions and fines, as well as, the costs associated with complying with anti-money laundering, counter-terrorist financing and sanctions regulations, are consistently highlighted as the primary drivers of de-risking - irrespective of jurisdiction.

Regulatory fines imposed since 2012 against global banks reached many billions of dollars and have had a chilling effect on the robustness of global correspondent relationships. The magnitude of these fines has instilled fear in many global banks and resulted in the re-assessment of risk appetites in an effort to avoid regulatory scrutiny of how an institution manages certain relationships. In many cases, the result is a pull back from entire countries or regions. As a result, value transfer finds new forms of movement, including underground.

Another key driver is cost. Global banks are spending billions of dollars a year on compliance with some banks individually spending over a billion dollars per year<sup>2</sup>. These costs are associated with a variety of compliance tasks that are required when opening an account for a new customer and for conducting ongoing monitoring of an existing customer. These compliance tasks include requirements such as identification of beneficial owners, negative news screening, investigations of suspicious transactions, filing of suspicious activity reports, document verification and on-site visits. While much of banks' spending is for critically

<sup>1</sup> International Monetary Fund. *Recent Trends in Correspondent Banking Relationships*, 2017. <https://www.imf.org/~media/Files/Publications/PP/031617.ashx>.

<sup>2</sup> Reuters Staff. "U.S., E.U. Fines on Banks' Misconduct to Top \$400 billion by 2020." Reuters, September 27, 2017. <https://www.reuters.com/article/us-banks-regulator-fines/u-s-eu-fines-on-banks-misconduct-to-top-400-billion-by-2020-report-idUSKCN1C210B>.



important tasks, many costly compliance tasks are repetitive and may distract institutions from the intended outcome of detecting and ultimately stopping illicit activity.

The combination of regulatory fears and associated costs has led many large, global financial institutions to reassess the upside of doing business in emerging and frontier markets. In other words, many institutions determined that the costs and risks associated with maintaining certain relationships are no longer worth the revenue generated. The result has been the termination of those relationships.

Smaller financial institutions, such as regional banks, may have lower revenue thresholds than large global banks and therefore, have a willingness to absorb terminated relationships. However, the compliance burdens are frequently too high for those smaller institutions to take on and actively manage those relationships. This has left terminated respondent banks – and the customers they serve – with limited or no means to reconnect to the international financial system and access services previously available.

### **Consequences of De-Risking**

#### *Financial Exclusion*

There have been short and long term consequences of de-risking. Research has demonstrated that de-risking has had financial inclusion consequences on emerging economies. In a World Bank report from November 2015 on the impact of withdrawals from correspondent banking, consequences such as decreases in lending, international wire transfers, cash management services and check clearing are highlighted among some of the most significant impacts at the local level<sup>3</sup>. According to a research report conducted by the Global Center on Cooperative Security and Oxfam in November 2015, decreased services have had “a ripple effect on financial access for the individuals and populations served by [terminated] businesses... effectively

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<sup>3</sup> The World Bank Group, *Withdrawal from Correspondent Banking – Where, Why and What to Do About It*, 2015. <http://documents.worldbank.org/curated/en/113021467990964789/pdf/101098-revised-PUBLIC-CBR-Report-November-2015.pdf>.

cutting off access to finances” and “isolating communities from the global financial system”<sup>4</sup>. Additionally, an IMF report from March 2017 indicates that small countries with low volumes of transactions in Europe, Central Asia, the Caribbean, Africa, and the Pacific Islands have experienced increased costs for remittance transfers.<sup>5</sup> These impacts have direct financial implications for individuals and businesses operating in these markets.

#### *Decrease in Transparency*

Beyond the direct financial impacts, it has been cautioned by the World Bank<sup>6</sup>, the Financial Action Task Force<sup>7</sup> and other groups that de-risking may unintentionally drive financial transactions underground or into shadow markets resulting in a reduction in overall transparency. If money is removed from the international financial system and transferred into unregulated channels, it becomes much harder to detect and monitor, and the risks of money laundering and terrorist financing in turn increase. It is well documented that channels with a low likelihood of detecting illicit activity, such as unregulated industries, are the channels more frequently used by money launderers and terrorist groups for movement of funds. As regulated entities, banks have higher likelihood of detecting illicit activity. Thus, keeping funds within the financial system maintains transparency and improves the likelihood of detecting illicit activity overall.

#### *Long-Term Impacts*

There has been a decline in the practice of de-risking over the last few years, with most of the termination of relationships having occurred between 2012 and 2015. Yet, the effects of those earlier practices remain. In the last 6 months alone, myself and my team have met with regulators and financial institutions in dozens of countries across Europe, Latin America, the

<sup>4</sup> Duman, Tracey and Shetret, Liat. Global Center on Cooperative Security. *Understanding Bank De-Risking and its Effects on Financial Inclusion*, 2015. [https://www.oxfam.org/sites/www.oxfam.org/files/file\\_attachments/rr-bank-de-risking-181115-en\\_0.pdf](https://www.oxfam.org/sites/www.oxfam.org/files/file_attachments/rr-bank-de-risking-181115-en_0.pdf).

<sup>5</sup> International Monetary Fund. *Recent Trends in Correspondent Banking Relationships*, 2017. <https://www.imf.org/~media/Files/Publications/PP/031617.aspx>.

<sup>6</sup> International Finance Corporation. *De-Risking and Other Challenges in the Emerging Market Financial Sector*, 2017. <http://documents.worldbank.org/curated/en/895821510730571841/pdf/121275-WP-IFC-2017-Survey-on-Correspondent-Banking-in-EMs-PUBLIC.pdf>.

<sup>7</sup> Financial Action Task Force. *FATF Takes Actions to Tackle De-Risking*, 2015. <http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-action-to-tackle-de-risking.html> and <http://www.fatf-gafi.org/documents/news/rba-and-de-risking.html>.

Middle East and Africa. These countries and institutions continue to struggle to reconnect to the international financial system. And for those who are able to do so, they are often subject to higher fees and increased due diligence by their correspondents – leading to higher costs of doing business. Furthermore, the loss of correspondent banking relationships can create a long-term stigma. For example, rating agencies have started to consider loss of correspondent banking relationships as a factor for downgrading the rating of a financial institution<sup>8</sup>. These long-term impacts should not be ignored.

### A Way Forward

With de-risking and its drivers receiving much attention over the last few years, both public and private sector players have presented potential solutions. A sustainable solution, however, will require a change in the overall cost benefit analysis for correspondents in high risk markets. This could be achieved by lowering costs and regulatory risk vis-a-vis the revenue potential of high risk business. Some possible approaches that could help enable this include the following:

**First, greater sharing of risk information to improve overall transparency.** Current due diligence practices require individual correspondents to collect information on a respondent from multiple data sources, keep that information up to date throughout the course of a relationship, monitor any changes in that information and then make assessments of what that information means about risk. The burden of these practices cause correspondents to overlook potential relationships and, rather than incur the time and cost to understand *individual entities*, make wholesale decisions based on *country risk*. Furthermore, given that correspondents typically share customers, the practice whereby each bank individually collects and assesses the available information results in industry wide redundancies. Greater information sharing – between both the public and private sector – improves information availability and transparency, which is a starting point to reducing the compliance burden.

**Second, use of third-party providers of independent, standardized assessments of a respondent's compliance with global standards.** The compliance burden can be further

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<sup>8</sup> International Monetary Fund. *Recent Trends in Correspondent Banking Relationships*, 2017. <https://www.imf.org/~media/Files/Publications/PP/031617.ashx>.

reduced through the use of standardized, independent third-party assessments of potential respondents' risk and compliance with international best practice. An independent assessment could serve as a baseline for a correspondent to enter into a relationship, thus reducing much of the upfront and ongoing diligence processes. This would result in cost savings and greater efficiencies across the industry. Furthermore, use of standardized assessments would provide institutional comparability across jurisdictions for use by governments, as well as, financial institutions. This increased visibility into the risk and compliance practices of particular institutions would also allow for better allocation of capacity building resources.

**Third, use of technology to lower AML/CFT compliance costs without the fear of regulatory backlash.** The use of technology to enable financial institutions to better understand their clients and manage their risk should be welcomed. Permitted reliance on innovative, technology based approaches, under proper oversight of the correspondent, can make due diligence more efficient and cost effective. Establishing channels for regulatory approval and support of innovative, technological solutions for compliance may give correspondents greater comfort in changing their current compliance behaviors and re-evaluating their risk appetites.

#### **Conclusion**

In conclusion, it is in the immediate and long-term interest of the U.S. and the integrity of the international financial system to ensure fast, growing emerging markets stay connected and have access to the dollar. However, it is equally important to protect the integrity of this system. Where there are emerging market institutions who can demonstrate their commitment to complying with international best practice, combating illicit finance and transparency more broadly, we should create avenues for their participation.

Thank you for taking the time to hold this Hearing and for allowing me to share my perspective on this important topic. I look forward to your questions.



Testimony of

John Lewis

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Corporate Affairs and General Counsel

United Nations Federal Credit Union

on behalf of

The National Association of Federally-Insured Credit Unions

"International and Domestic Implications of De-Risking"

Before the

House Financial Services Subcommittee on Financial Institutions and Consumer Credit

June 26, 2017

**Introduction**

Good afternoon Chairman Luetkemeyer, Ranking Member Clay and Members of the Subcommittee. Thank you for the invitation to appear before you today. My name is John Lewis and I am testifying today on behalf of the National Association of Federally-Insured Credit Unions (NAFCU). I am the Senior Vice President of Corporate Affairs and General Counsel of United Nations Federal Credit Union (UNFCU), headquartered in Long Island City, New York.

UNFCU was established in 1947 by 13 United Nations staff members. Some 70 years later, we have over 127,000 members and \$5.2 billion in assets. Still, UNFCU remains committed to its mission of "serving the people who serve the world."

As you are aware, NAFCU is the only national organization exclusively representing the interests of the nation's federally-insured credit unions. NAFCU's member credit unions collectively account for approximately 70 percent of the assets of all federal credit unions. It is my privilege to submit the following testimony on behalf of NAFCU, our credit unions, and the 113 million credit union members that have been impacted by the compounding regulatory burdens placed on the industry. We appreciate the opportunity to speak about how "de-risking" affects credit unions and their members.

### **NAFCU's Principles of a Healthy Regulatory Environment for Credit Unions**

NAFCU has established a set of tenets that we believe are important aspects of a healthy regulatory environment for credit unions. Some key elements of these tenets can also be applied when looking at the issue of “de-risking.”

- **NAFCU supports a regulatory environment that allows credit unions to grow.** NAFCU believes that there must be a regulatory environment that neither stifles innovation nor discourages credit unions from providing consumers and small businesses with access to credit. It is important that concerns about regulators cracking down on risk do not stifle innovation, nor overburden credit unions to the point that they cannot serve members.
- **NAFCU supports appropriate, tailored regulation for credit unions and relief from growing regulatory burdens.** Credit unions are swamped by an ever-increasing regulatory burden from the Bureau of Consumer Financial Protection and other regulatory entities, often on rules that are targeting bad actors and not community institutions. NAFCU supports cost-benefit analysis in regulation, and wants to ensure that we have an effective regulatory environment where positive regulations may be easily implemented and negative ones may be quickly eliminated. NAFCU also believes that enforcement orders from regulators should not take the place of regulation or agency guidance to provide clear rules of the road. This includes seeking regulatory relief and reform that allows credit unions to better serve their members, including in the Bank Secrecy Act and Anti-Money Laundering arena.
- **NAFCU supports a fair playing field.** NAFCU believes that credit unions should have as many opportunities as banks and non-regulated entities to provide provident credit to our nations' consumers. NAFCU wants to ensure that all similarly situated depositories follow the same rules of the road and unregulated entities, such as predatory payday lenders, do not escape oversight. We also believe that there should be a federal regulatory structure for non-bank financial services market players that do not have a prudential regulator, including emerging Fintech companies.
- **NAFCU supports government transparency and accountability.** NAFCU believes regulators need to be transparent in their actions, with the opportunity for public input, and should respect possible different viewpoints. When credit unions provide important information to regulators, the regulator should be transparent in why it was requested and how it is to be used.
- **NAFCU supports a strong, independent NCUA as the primary regulator for credit unions.** NAFCU believes that the National Credit Union Administration is best situated with the knowledge and expertise to regulate credit unions due to their unique nature.

The current structure of NCUA, including a 3-person board, has a track record of success. NCUA should be the sole regulator for credit unions and work with other regulators on joint rulemaking when appropriate. Congress should make sure that NCUA has the tools and powers that it needs to effectively regulate the industry, including in areas that deal with riskier members.

#### **De-Risking and Credit Union Challenges**

NAFCU and its member credit unions have consistently recognized the importance of the *Bank Secrecy Act* (BSA) and Anti-Money Laundering (AML) requirements, as further outlined by the Federal Financial Institutions Examination Council (FFIEC), in assisting in the prevention of tax evasion, money laundering, terrorism financing, and other illicit activity. Credit unions are fierce supporters of efforts to combat criminal activity utilizing our financial systems. Our members work closely with examiners to ensure consistent application of BSA risk assessments and regularly inform us that the publication of periodic BSA/AML guidance is very helpful. Still, the implementation of BSA requirements remains a burden for many of our smaller members, especially in the post-financial crisis regulatory environment.

Given credit unions' field of membership limitations, it is important for credit unions to have the potential to serve everyone in their field of membership, including legitimate businesses. Some businesses may come with heightened risks due to the nature of their business. These higher risk businesses increase compliance burdens, costs, and pressures on credit unions. With our unique field of membership at UNFCU, we have been fortunate to have good relationships with our examiners who have worked with us in riskier areas. However, NAFCU has been informed by some of its member credit unions that, while National Credit Union Administration (NCUA) examiners generally will not direct credit unions to stop providing services to higher risk



individuals or businesses, these credit unions can feel pressured by examiners to limit services in order to avoid future examination issues.

It is important to note that when a credit union is serving a higher risk individual or business, they are very thorough in their evaluation and record-keeping; however, when examiners evaluate that relationship, they can be very demanding of the credit union. NAFCU has heard reports that sometimes examiners go beyond what is required by guidance and take action if these heavier demands are not met, even if no issues are found. In some instances the examiner finds no problems on site, but comes back with new requirements after a supervisor's review. NAFCU has even heard of examples of credit unions being downgraded in their CAMEL rating solely for serving certain types of businesses, despite no problems being found in their AML program. This additional pressure and scrutiny from examiners can lead institutions to "de-risk" by limiting services for certain types of members.

UNFCU as well as many other credit unions enjoy good working relationships with their examiners and recognize the importance of working with NCUA, and other regulators, as they examine higher risk members. Sometimes the pressure to "de-risk" comes not from the regulators, but from law enforcement. Although credit unions that deal with higher risk members recognize the importance of sharing critical information with law enforcement, including through subpoenas, some report that they have received unreasonably broad subpoenas asking for all information and correspondence related to any members in a certain type of business. The threat of overbroad investigatory demands makes credit unions hesitant to provide services to legitimate businesses that are targeted as higher risk.

Credit unions can also be impacted by others making the decision to "de-risk." At UNFCU, some of our members have international ties and some are located abroad. As a result, we are presented with a unique set of risks for which we have learned to adapt. We have found that some of UNFCU's traditional partners and vendors have re-evaluated their relationship with UNFCU with more scrutiny, or even "de-risked" by ending our long-standing relationship due to the fact that we serve higher-risk members, despite having no previous problems. This loss of partners and vendors has led to a significant disruption of services and increased costs to us and our members, forcing us to bring on additional staff in order to maintain established service levels. Our unique membership coupled with our vendor relationships gives UNFCU a strong understanding of the challenges from both sides of the de-risking issue.

#### **Ideas to Address De-Risking**

In a U.S. Government Accountability Office (GAO) report released in February concerning the impact of "de-risking" by financial institutions in the Southwest, the GAO made the recommendation that FinCEN and the federal banking regulators undertake a retrospective review of the BSA regulations with a focus on how regulatory concerns may be influencing financial institutions' willingness to provide banking services. According to the report, regulators have not fully assessed de-risking trends in previously conducted reviews of BSA/AML regulations.

Credit unions continue to work with FinCEN and other regulators to develop ways to provide services to legitimate higher risk businesses without incurring compliance burdens and costs that are so onerous that "de-risking" becomes the only option. Some ideas for improvement include:

- Creating a "safe-harbor" for the financial institution providing services to high risk accounts if they have met certain requirements in the scrutiny of those accounts.
- Ensuring that risk-based review requirements for financial institutions are understood by examiners. Credit unions report that examiners sometimes request the same maximum review of all entities in higher risk fields, despite varying levels of actual risk.
- Not making the financial institution the "de facto" regulator of a business. It is not uncommon for the financial institution to be pushed to scrutinize legitimate businesses that are already regulated by another entity (often the state). While it may make sense for a financial institution to verify registration and licensing, they should not be forced to verify levels of compliance by the business.

#### **Legislative Proposals to Help**

NAFCU supports legislative proposals to address some of the issues raised above and to improve and streamline the BSA/AML process to provide meaningful relief to credit unions in areas where they may be forced to "de-risk."

**H.R. 6068, the *Counter Terrorism and Illicit Finance Act***

H.R. 6068 takes important steps to update and modernize the BSA/AML regime. In particular, we support the legislation's proposed increases to the dollar-amount thresholds for Suspicious Activity Reports (SARs) and Currency Transaction Reports (CTRs). The current thresholds were set in 1996 and are now outdated, and because the thresholds have failed to keep pace with inflation, they have led to increased filings that provide questionable benefits. We are also pleased to see that the legislation would require the Secretary of the Treasury to work to streamline and improve the current reporting requirements.

We also appreciate H.R. 6068's focus on encouraging more coordination between law enforcement priorities and financial institution examiners. Although not in UNFCU's experience, many of NAFCU's members have indicated that their examiners are too heavily focused on auditing absolute numbers of SAR filings and identifying procedural issues that do not materially affect risk. As an example, some credit unions have experienced situations where an examiner makes a finding on a CTR based on a pure technicality, such as a strict timing deadline, which does not truly affect the usefulness of the CTR as they are often not as time-sensitive. Clarifying priorities for the nation's BSA/AML policy will help in this regard.

H.R. 6068 also contains important provisions that help ensure financial institutions can innovate in the BSA/AML space, including requiring FinCEN to establish a no-action letter process, and would improve the ability of financial institutions to share suspicious activity.

The bill contains a provision providing an 18-month safe harbor for good faith compliance with the new FinCEN Customer Due Diligence (CDD) Rule as well as the studies regarding the collection of beneficial ownership information as part of the CDD Rule. NAFCU would also support, and encourages the Committee to consider, expanding these provisions to help ensure credit unions have access to beneficial ownership information from the state in which the corporations or limited liability companies were formed.

**H.R. 4545, the *Financial Institutions Examination Fairness and Reform Act***

NAFCU is pleased that the House has already passed this important legislation introduced by Representatives Scott Tipton (R-CO) and Carolyn Maloney (D-NY) to help create and ensure an independent process to appeal examiner findings. Enacting this legislation would be an important step to provide relief for financial institutions experiencing perceived pressures from examiners leading them to "de-risk" certain entities.

**H.R. 2706, the *Financial Institution Customer Protection Act of 2017***

NAFCU is pleased to see that the House has also already passed this important legislation that would ensure "Operation Choke Point" policies will not be used by regulators to prevent the provision of financial services to a member without a valid reason for doing so that is not based solely on reputation risk. We thank Chairman Luetkemeyer for his leadership on this issue.

**International Remittances**

Credit unions have the power to provide remittances to individuals in their field of membership; however, the remittance rule issued by the Bureau of Consumer Financial Protection after the

*Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act), has led many credit unions to "de-risk" and stop that service. Credit unions do not have the ability to control the end-to-end process of an international remittance in the same way that a large international financial institution does. The inability of credit unions to comply with the new disclosure requirements has created additional risks for those credit unions who offer remittance services. Now many credit unions must partner with third-party providers to provide remittance services, often incurring additional costs, which are then passed along to their members.

Some credit unions have determined that originating remittances was not worth the additional cost and risk, and no longer offer the service. The remittance rule is an example of an area where the Bureau could have used its authority under Section 1022 of the Dodd-Frank Act to exempt credit unions, but chose not to do so. As a result, the "de-risking" of remittance services has sent some individuals to underground and online channels to transfer funds, often avoiding the scrutiny such international transactions could have faced by doing it via a regulated financial institution. NAFCU is pleased to see that the Bureau's Acting Director Mick Mulvaney is reviewing this rule.

#### **Marijuana Banking**

Although not the subject of this hearing, the banking of individuals and businesses in the marijuana industry is an area of higher risk and scrutiny. The growing number of states that have legalized marijuana in some form has led to uncertainty for credit unions and other financial institutions on how to provide financial services to businesses engaged in these state-approved industries. The large amounts of cash generated by these businesses, creates risk as well as these

businesses are not able to use financial institutions. Not all credit unions have such businesses in their fields of membership, nor have an interest in providing these services. However, others that may be interested have "de-risked" and declined to provide services, due to the legal uncertainty surrounding these businesses. NAFCU encourages Congress to enact legislation that would address the legal ambiguities and uncertainties in the provision of financial services to state-approved marijuana businesses.

### **Conclusion**

NAFCU and its member credit unions recognize the importance of the BSA/AML regime as well as the importance of regulator and law enforcement scrutiny of riskier businesses. Given UNFCU's field of membership, we serve as an example that it can be done. Nonetheless, heavy compliance costs, burdens, and pressures from regulators and law enforcement when dealing with higher risk members and business, can lead many to "de-risk" and stop providing services to them. In addition to advancing the proposals and legislation outlined in my testimony, Congress can help by working with financial regulators and law enforcement to alleviate these burdens and pressures. NAFCU stands ready to work with you in this regard. Thank you for the opportunity to appear before you today. I welcome any questions you may have.



## CARIBBEAN-CENTRAL AMERICAN ACTION

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Testimony of Sally Yearwood

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House Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

Tuesday, June 26, 2018

### **International and Domestic Implications of De-Risking**

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

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

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

I will start with an example from the Cayman Islands. In 2015, on instruction from U.S. correspondent banks, the two Cayman Islands banks that provided accounts to money transfer businesses (MTBs) severed those relationships rather than risk losing their U.S. banking relationships. The MTBs, which provided critical services to people who send remittances to their families, were shut down. During the period that there were no MTB’s, work-arounds had to be found to address the problem. This led to the now-infamous



experience of one group moving cash in planes in order to make sure that the vulnerable population impacted by the termination had access to finance. One MTB was able to reopen a few months later, and today there is still only one MTB able to operate there.

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

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

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

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

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

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

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

#### HOW DID WE GET HERE?

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

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

#### WHAT CAN BE DONE:

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

There are a number of tools that exist to help.

First, the United States Department of the Treasury continues to provide important assistance to the region to help it strengthen its compliance capacity. According to conversations with stakeholders, U.S. banks are provided with a certain comfort level when Treasury is actively providing technical assistance in these jurisdictions. More money could be allocated to the Department to help it work with the region, and, where possible,

help the region acquire the technology that will strengthen its compliance profile. Another idea that has been proffered related to the Treasury Department: if we assume that larger banks are not going to go into the market simply because of the profit ratio, could there be a scenario wherein community and minority banks are encouraged to serve the Caribbean using the platforms within large banks, with the large banks who lend their platforms receiving credit under the Community Reinvestment Act (CRA)?

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

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

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

#### **Conclusion:**

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

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

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

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

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