PACIFIC ISLANDS FORUM

The Decline of Correspondent Banking in Pacific Island Countries



State of knowledge and what can be done to fix the problems

July 2023

Contents

Key acronyms in this paper 2

Executive summary 4

1 Background to the study 10

2 Introduction and purpose 10

2.1 De-risking and de-banking 13

2.2 De-risking and CBRs 15

2.3 ML/TF/PF risk in the Pacific 17

3 Recent developments of relevance to the Pacific 21

4 The extent of CBR decline in the Pacific 23

5 Impact of decline in CBRs on exports 30

6 Impact of decline of CBRs on remittance costs 30

7 Policy suggestions made to date 32

7.1 Improving ML/FT/PF risk management 33

7.2 Improving the enabling environment for CBR services 38

7.3 Countering the effects of complete de-banking 39

8 Stocktake of solution initiatives undertaken to-date 39

8.1 Improving ML/FT/PF risk management 40

8.2 Improving the enabling environment for CBR services 43

8.3 Recommended initiatives not yet actively explored by PIF members 45

8.4 Stocktake summary 46

9 Recommendations 52

10 List of background Technical Papers 57

Key acronyms in this paper

ADB	Asian Development Bank
AML	Anti Money Laundering
APG	Asia Pacific Group on Money Laundering
AUSTRAC	Australian Transaction Reports and Analysis Centre
BIS	Bank of International Settlements
CBDC	Central Bank Digital Currency
CBR	Correspondent Banking Relationships
CDD	Customer Due Diligence
CFT	Combating the Financing of terrorism
CPF	Combating proliferation
CPMI	Committee on Payments and Market Infrastructures
DFAT	Department of Foreign Affairs and Trade (Australia)
DFS	Digital Financial Services
eKYC	Electronic Know Your Customer
EU	European Union
FATCA	Foreign Account Tax Compliance Act
FATF	Financial Action Task Force
FinCEN	Financial Crimes Enforcement Network
FSB	Financial Stability Board
FT	Financing Terrorism
GAO	Government Accountability Office
GDP	Gross Domestic Product
IFC	International Finance Corporation
IMF	International Monetary Fund
KYC	Know Your Customer
LEI	Legal Entity Identifier
ML	Money Laundering
MTO	Money Transfer Operator
NPO	Non-profit Organisation
NRA	National Risk Assessment
PF	Proliferation Financing
PFTAC	Pacific Financial Technical Assistance Centre
PFIC	Pacific Financial Intelligence Community
PI	Payment Institution
PIF	Pacific Islands Forum
PIRI	Pacific Islands Regional Initiative

PSP	Payment Service Providers
RBA	Reserve Bank of Australia
RBNZ	Reserve Bank of New Zealand
RSP	Remittance Service Provider
SPGM	South Pacific Governors Meeting
SWIFT	Society for Worldwide Interbank Financial Telecommunications
UK	United Kingdom
US	United States of America
WB	World Bank

This report was compiled by Katia D'Hulster (Lead Financial Sector Specialist, World Bank), Nicholas Morris, Sue Jaffer and Louis de Koker (all World Bank consultants).

Earlier drafts of the report benefited from review comments by Jean Pesme (Global Director, World Bank), Nilima Chhabilal Ramteke (Senior Financial Sector Specialist, World Bank), Vinda F. Montes Herraiz (Senior Financial Sector Specialist, World Bank), Ian Richard Matthews (Consultant) Chris Becker (IMF), DFAT (Australia), the MFAT (New Zealand) and AUSTRAC. The ADB, IMF, PFTAC, APG and AUSTRAC contributed to the stocktake of technical assistance activities.

Executive summary

Background

At the Pacific Islands Forum (PIF) Economic Ministers meeting held in Vanuatu in August 2022, Ministers were concerned to note the continued withdrawal of correspondent banking relationships (CBRs) in the Pacific, also known as “de-risking”.

Correspondent banking is the provision of payment banking services by one bank to another bank where both institutions are based in different countries. These relationships are at the core of the global payments system, enabling cross-border payments such as remittances and export revenues. In particular, the Ministers expressed grave concerns regarding the potential impact on accessible and affordable banking services in the region. Maintaining CBRs is a prerequisite to attracting investment, promoting trade, and receiving remittances. The meeting participants also noted the impact of losing CBRs on the lives of Pacific Islanders, including seasonal workers, small and medium enterprises, and other vulnerable groups.

As an immediate action, the PIF Secretariat decided to conduct a study on the closure of CBRs in the region, with the aim of understanding the current situation in member countries, the remedial actions undertaken, the lessons learnt and potential remedial actions that might prevent further de-risking. The Secretariat requested the World Bank’s assistance with this task.

This report consists of a main report and eight technical papers (TPs) and lays out recommended actions for the Pacific Islands (PIs) for combatting de-risking at a regional level. The report considers the developments in relation to the Cook Islands, Fiji, French Polynesia, Kiribati, Nauru, New Caledonia, Niue, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu.

De-risking and why it matters

Through their CBRs, banks access financial services in other jurisdictions and provide cross border payments services to their customers, supporting international trade and financial inclusion. De-risking is the withdrawal of banking services in response to anti-money laundering (AML), combating of financing of terrorism (CFT) and proliferation financing (CPF) concerns. It is defined by the Financial Action Task Force (FATF), the global standard-setting body for AML/CFT/CPF, as:

> “the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risk in line with the FATF's risk-based approach” (FATF 2014).

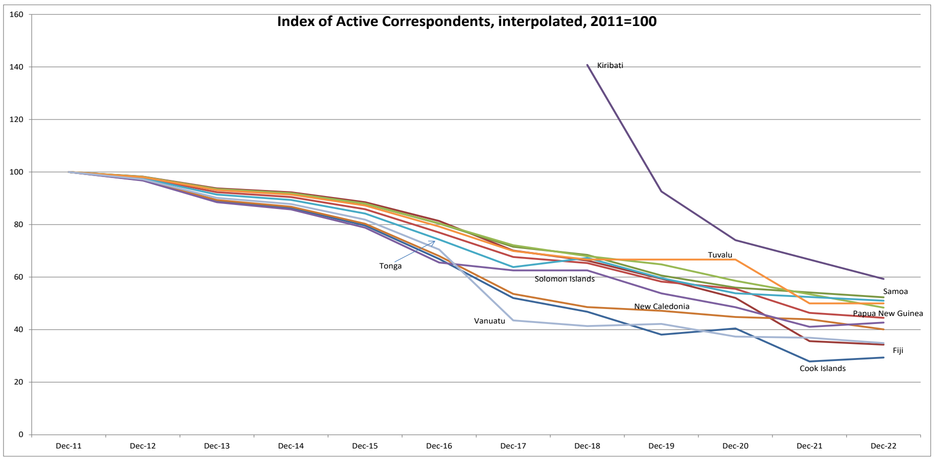
De-risking results in not only fewer and lesser quality CBRs but potentially also in more limited services being rendered at a higher cost. Thus it can hamper remittances and prevent segments of the population from efficiently accessing the financial system, or it can delay the transfer of international development funds and humanitarian and disaster relief. It can also drive financial activity out of the regulated financial system into informal channels.

A lower number and quality of CBRs can also have a broad economic impact. Econometric analysis carried out for this study found evidence that the decline in CBR has had an impact on export performance. Detailed analysis of remittance flows identified high costs relative to Southeast Asia and South Asia, findings that were reinforced by our econometric analysis (TP 6).

How important is de-risking?

The extent to which correspondent banking facilities have been withdrawn from PIF countries is recorded in data held by SWIFT[1]. However, SWIFT does not publish these data on an individual country basis and, due to data protection concerns, has not agreed to make them available for this study. The data for an individual country can be requested by the relevant central bank or authority, but SWIFT does not allow the data to be passed on to third parties, such as the World Bank.

SWIFT has released limited data publicly via the Committee on Payments and Market Infrastructures (CPMI) of the Bank for International Settlements (BIS), on four occasions, in 2023, 2020, 2019 and 2018. Globally, CBRs have been declining since the turn of the millennium but the PIs have been disproportionally affected. Based on publicly available data, the total number of active correspondents of the PIs has declined significantly since 2011:



Source: SWIFT data, presented through CPMI and PIRI, World Bank staff estimates

That said, the CBR situation is uneven across the PIs. Some countries experienced higher levels of CBR loss than others, such as Fiji, the Cook Islands and more recently Kiribati. Some are vulnerable because they have only a very small number of CBRs left, while others enjoy a range of CBRs. Problems are more acute for USD and EUR accounts than for other currencies.

A survey was developed by the World Bank team to assess the current CBR situation in nominated PIs, and to seek views on vulnerability and appropriate responses. Unfortunately, only three responses were received, and no response provided specific CBR-related data.

Importantly, there is no consensus on how many CBRs each country should aim for and what the quality of those should be to ensure that the country's CBR connectivity remains resilient. Adequate CBR resilience levels should be determined and regularly monitored so that responses can be proactive rather than reactive in nature.

[1] Society for Worldwide Interbank Financial Telecommunications, a member owned cooperative whose shareholders represent about 3,500 member organisations.

What are the key drivers of de-risking in the Pacific?

Profitability and risk/reward considerations

International banks are withdrawing their CBRs partly due to profitability and risk/reward considerations. These considerations generally include the cost of resources, the cost of implementing new regulations, and the impact of legal and reputational risks. CBR services are often not profitable services in their own right but may nevertheless be offered where they generate sufficient business for the correspondent bank. Jurisdictions present different CBR business cases and some may be more attractive due to the size of their economy or their enabling environment for the banking sector. While the PIF has very limited authority to influence business decisions of financial institutions, a better understanding of the drivers related to the enabling environment for banking may assist authorities to formulate policies that are targeted at overcoming any disadvantages of scale and scope and hence have a positive impact on CBRs.

AML/CFT/CPF-related considerations

Effective money laundering and financing of terrorism and proliferation (ML/FT/PF) risk assessments are a critical underpinning for a risk-based regulatory framework. To assess this, the FATF views ML/FT/PF risk as a function of three factors: threat, vulnerability and consequence.

Crime **threat** levels, for example the level of organised crime activity in the region, are generally - though not uniformly - low. PIs may, however, be exploited as transit jurisdictions or to hide beneficial ownership, thereby facilitating criminal activity including tax fraud elsewhere. The relevance of such ML/FT/PF abuse from a CBR risk assessment perspective depends on whether, and the extent to which, proceeds of such crimes (and financing in the case of FT/PF) also flow through the financial system of the jurisdiction and potentially through the CBR services.

Vulnerability levels of PIs are generally viewed as high. Vulnerability is mainly assessed using two dimensions: technical compliance with the FATF standards and the effectiveness with which the standards have been implemented. Overall levels of effectiveness of implementation of AML/CFT/CPF measures are low in the PIs, meaning that vulnerability levels will tend to be assessed as high.

The **consequences** of events of criminal abuse are often assessed as important regardless of the amounts involved. This means that the consequences of transactions involving terrorist financing are treated as equally serious whether they involve \$100 or \$1 million, and regardless of their potential application. Smaller jurisdictions may therefore be classified as higher risk although ML/FT/PF threat levels may be low and abuse, when it occurs, may involve only modest amounts.

Reduced CBRs, which may also lead to declining economic activity and higher costs, especially for remittances, is a consequence of higher AML/CFT/CPF risks. It may also be an unintended consequence of aspects of FATF regulations.

For remittances, authorities can perform corridor risk assessments to identify, analyse and assess ML/TF/PF treats and vulnerabilities in a particular corridor together with their consequences. These should enable better calibration of regulation and reduced compliance costs. They will also provide information for CBR-related risk decisions.

What actions have been taken?

TP4 presents a stocktake of the large number of initiatives that are being undertaken or investigated by PIF members to strengthen AML/CFT/CPF and counter de-risking. These can be clustered into the following groups:

a) Improving ML/FT/PF risk management
   - Better data
   - Better regulation
   - Better AML/CFT/CPF capacity
b) Improving the enabling environment for CBR services
   - Supporting digital financial services
   - Improving national infrastructure
   - Adopting regional/shared solutions
c) Countering the effects of complete CBR de-banking

Examples of important initiatives include improving local laws and regulatory, supervisory and investigative functions; improving national identity infrastructures; exploring national electronic Know Your Customer (eKYC) utilities; the adoption of a de-risking action plan by Pacific Islands Regional Initiative (PIRI) of the Alliance for Financial Inclusion;[2] the establishment of the Pacific Financial Intelligence Community (PFIC); and the successful piloting of a digital voucher remittance system in Tonga ('Ave Pa'anga Pau) allowing safer, cheaper remittances from Australia and New Zealand. While some of these actions may have slowed the tide of decline in Pacific CBRs and others countered some of the negative impacts of de-risking, they have not resulted in a significant strengthening of CBR levels.

Relevant global developments

At the request of the G20, the Financial Stability Board (FSB) has developed a roadmap to enhance cross-border payments (FSB 2020), in coordination with the CPMI and other relevant international organisations and standard-setting bodies, including the FATF. The roadmap has 19 building blocks and is designed to address the main challenges identified in cross-border payments – high costs, low speed, limited access and insufficient transparency – and the frictions that contribute to those challenges. A broad range of pilot programs are being undertaken as part of this project, and the results may lead to important changes in the medium and longer term. Relevant work programs include, for example:

- The investigation of safe payment corridors aimed at encouraging their implementation. This work focuses on establishing pilot risk assessments for likely lower ML/TF risk corridors for remittances using a World Bank and IMF-developed draft methodology (Building Block 7);
- Improving national identification systems, KYC utilities and cross-border recognition of national identity requirements and frameworks (Building Block 8); and
- The use of unique identifiers such as Legal Entity Identifiers (LEIs) (Building Block 16).

[2] Some of the initiatives, for example the PIRI action plan against de-risking, only covered a subset of the PI countries.

In addition, the FATF is contemplating steps to limit unintended de-risking consequences of its standards, especially in relation to non-profit organisations (FATF 2022). In addition, agencies such as the US Treasury (Department of Treasury 2023), the European Banking Authority (EBA 2023) and AUSTRAC (AUSTRAC 2023a) have adopted new strategies and guidance to counter unnecessary de-risking, aimed at specific customer groups. US Treasury's 2023 de-risking strategy was informed in part by concern that widespread de-risking could also reduce the centrality of the U.S. financial system and further accelerate efforts by some jurisdictions to reduce their dependency on the U.S. dollar and the U.S. financial system.

These developments reflect a global recognition of the de-risking problem and a willingness to work towards appropriate solutions.

Recommendations

To counter CBR losses in the Pacific, there is no silver bullet or quick fix. The report makes a number of recommendations which will work in combination and will require sustained effort and continued monitoring of progress in implementation.

1. The Forum should continue to support action by Forum members to meet global financial standards and to collaborate with counterparts to improve tax transparency.

2. The Forum should support broad Pacific Island piloting of the draft remittance corridor risk assessment methodology developed by the World Bank and the IMF. The Secretariat should analyse the outcomes of these assessments to inform appropriate risk assessment methodologies that would provide improved risk-related information to respondent and correspondent banks, AML/CFT/CPF-regulated businesses and their regulators in relation to the Pacific.

3. The Secretariat should encourage and guide efforts by central banks and Ministries of Finance of members to collect relevant CBR data and support the reporting of annual trends to Forum ministers. This may include negotiating better access to SWIFT data for the region.

4. The Secretariat should assess the strengths and gaps in current financial integrity information-sharing frameworks and practices among members in relation to key Pacific payment corridors and advise on appropriate improvements and frameworks to support alignment, where required.

5. The Secretariat should provide a platform for Pacific engagement with appropriate parties to key Pacific CBR corridors to explore the feasibility and design of cross-border public-private partnerships and regulatory safe harbour CBR frameworks for Pacific jurisdictions.

6. The Secretariat should undertake a diagnostic assessment of the enabling environment for the banking sector to identify opportunities for strengthening. The first step would be to develop an appropriate methodology for such a diagnostic.

7. The Secretariat should advise on an appropriate regional strategy in relation to the innovations and changes that may flow from the G20 'Roadmap for Enhancing Cross-border Payments' project. This should be a regional initiative to overcome capacity and resource constraints.

8. The Secretariat should develop a CBR resilience framework, take stock annually of de-risking actions and report on progress towards CBR resilience.

The main paper is accompanied by 8 technical papers:

1. De-risking and de-banking in the context of AML/CFT regulations
2. Literature Review: Stocktake of initiatives being undertaken by PI countries
3. Literature Review: Extent and impact of CBR decline on PI countries
4. Evidence from previous studies on progress made in each PI country
5. Analysis of questionnaires
6. Empirical analysis
7. List of references
8. Acronyms

1 Background to the study

During August 10-12, 2022, the Pacific Islands Forum Economic Ministers met in Vanuatu to exchange views on key economic issues and challenges affecting the region. The meeting took place in the context of widespread COVID-19 outbreaks in the region, as opposed to easing pandemic in most of the world, as well as the severe inflationary impact of the Russia-Ukraine war.

Along with the devastating impact of the pandemic and global energy prices on the member country economies, Ministers were concerned to note that the withdrawal of CBRs in the Pacific is continuing. Correspondent banking is the provision of payment banking services by one bank to another bank where both institutions are based in different countries. These relationships are at the core of the global payment system, enabling for example cross-border payments, such as remittances and commercial payments.

A major reason often cited for withdrawal of banking services is de-risking in response to anti-money laundering, combating of financing of terrorism and combating of proliferation financing (AML/CFT/CPF) concerns. "De-risking", in this context, is defined by the Financial Action Task Force (FATF), the global standard-setting body for AML/CFT/CPF as:

> "the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risk in line with the FATF's risk-based approach" (FATF 2014).

In particular, the Ministers expressed grave concerns regarding the impact of de-risking on CBRs in the Pacific, given its potential impact on accessible and affordable banking services in the region. Maintaining CBRs is a prerequisite to attract investment, promote trade, and receive remittances. The meeting participants also noted the impact of losing CBRs on the lives of Pacific Islanders, including seasonal workers, small and medium enterprises, and other vulnerable groups.

In the area of CBRs, the Ministers acknowledged the complex mix of factors that contribute to de-risking terminations and restrictions of banking services in the Pacific and agreed to continue the dialogue with Asia Pacific Group on Money Laundering and the Financial Action Task Force (FATF) development processes, considering the Pacific's unique risks and context.

As an immediate action, the PIF Secretariat decided to conduct a study on the closure of CBRs in the region, with the aim of understanding the current situation in member countries, lessons learnt and potential remedial actions to prevent de-risking, and requested the World Bank's assistance.

2 Introduction and purpose

A CBR involves one financial institution, referred to as the correspondent, providing banking services to another financial institution, known as the respondent. These institutions operate in different countries through permanent establishments. CBRs enable the respondent to provide its own customers with cross-border products and services that it cannot provide itself, especially in jurisdictions where it lacks a physical presence.

CBRs may be used in various ways, for example (Coelho et al 2020, AUSTRAC 2023):

- *Traditional correspondent banking*: the correspondent bank opens and maintains an account for a respondent bank and handles its payments. This arrangement allows the respondent bank to provide equivalent services to its own customers. However, the customers of the respondent bank do not have direct access to the correspondent banking account.
- *Nested correspondent banking*: a bank's correspondent relationship is used by a number of indirect respondent banks, also known as "nested banks". These nested banks conduct transactions and access financial services through their direct respondent's account with the ultimate correspondent. Unlike the traditional correspondent banking arrangement there is an additional bank mediating between the nested banks and the correspondent bank.
- *Payable-through or pass-through accounts*: the correspondent banking account of the respondent bank can be accessed directly by the respondent bank's customers. These customers can directly conduct their transactions through this account by making deposits and writing cheques on the account.

Typically, a correspondent bank has only limited information about the respondent bank's customers and the nature of their transactions. CBRs hold money laundering, terrorist financing and proliferation financing (ML/FT/PF) risk for correspondent banks. The level of this risk is largely dependent on the adequacy of the AML/CFT/CPF measures implemented by the respondent bank.

CBRs are important, as they provide the backbone of the international banking system. They provide the infrastructure for cross-border payments and are therefore the means whereby international trade payments and remittance flows are facilitated. Where CBRs entail the involvement of international banks in smaller island economies, they bring innovation and facilities that may not otherwise be available. If the number and/or quality of CBRs falls, this creates risks for the competitiveness of the banking system, and may put upward pressure on remittance costs and have a detrimental impact on, for example, trade finance. It may also drive remittance flows to institutions with a lower AML/CFT/CPF capacity and, depending on the extent of the loss, also into informal channels, thereby undermining the effectiveness of AML/CFT/CPF measures. Significant CBR loss may also affect the flow of development aid.

It is now well established that the Pacific Islands, in common with other jurisdictions such as those in the Caribbean, have faced a steep reduction in CBRs over the past two decades. Several major banking groups have also decided, for a variety of reasons, to withdraw banking services from particular Pacific Island countries.

Changing technologies have complicated matters further, with banks' business models coming under threat from new FinTech entrants. In regions such as the Pacific with limited inter-bank competition, fewer CBRs may permit dominant banks to charge higher prices than they would in a more competitive environment. Small countries with limited technical capacities and financial infrastructure may suffer most.

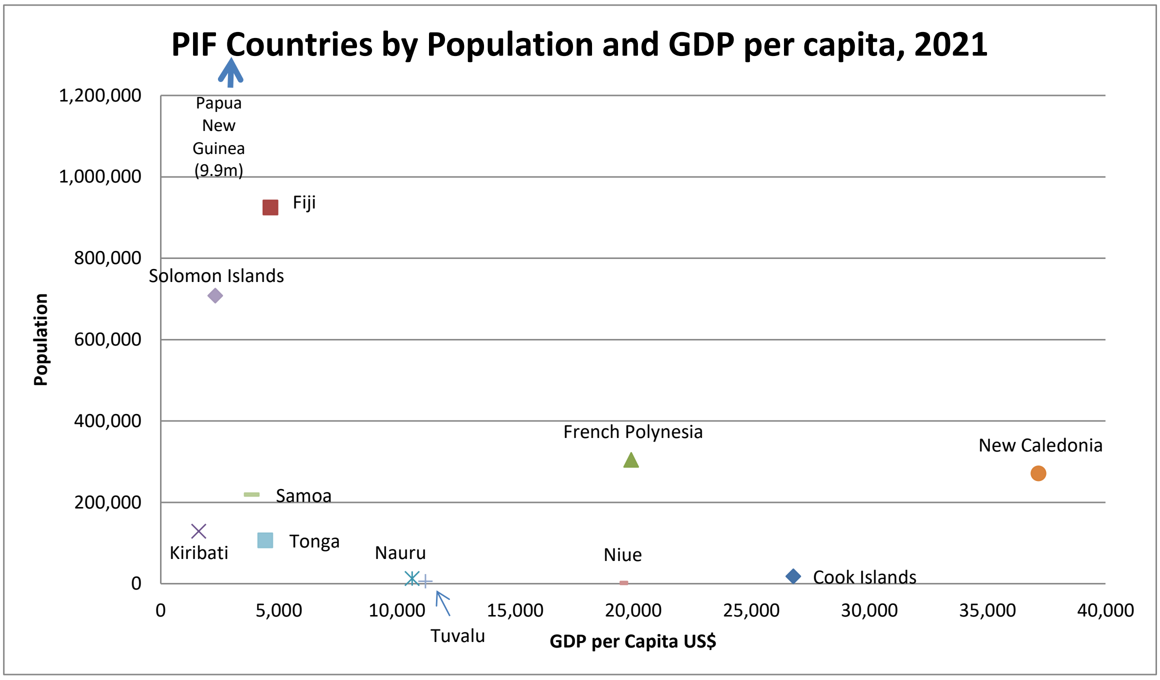
Technology and FinTech can provide powerful alternatives and solutions (Alliance for Financial Inclusion 2016, Davidovic et al 2019). eKYC (electronic Know Your Customer measures) and digital ID systems may enable counterparties to source trusted, up-to-date KYC information, thereby providing greater comfort to correspondent banks. Data analytics can help demonstrate the payments flow (origin and destination of funds) and integrity levels. Greater reliance on data and technology must be supported, however, by appropriate data protection, cyber security and consumer protection measures. These may be challenging for small jurisdictions to provide and maintain.

Global policy concern regarding "de-risking" has been building since 2013. Various solutions have been proposed (e.g. CPMI 2016, FSB 2016). While the implementation of some of these solutions may have slowed the rate of CBR loss globally, they have not resulted in a reversal of the trend of diminishing CBRs. Current policy initiatives range from the FATF contemplating steps to limit unintended de-risking consequences of its standards (FATF 2022), through to agencies such as the US Treasury (Department of Treasury 2023), the European Banking Authority (EBA 2023) and AUSTRAC (AUSTRAC 2023c) adopting new strategies and guidance to counter unnecessary de-risking, aimed at specific customer groups or more generally. In parallel the Financial Stability Board (FSB), in collaboration with other financial standard-setting bodies and regional and national regulators are progressing with the G20 Roadmap for Enhancing Cross-border Payments (FSB 2023). Reforms in this space may address CBR de-risking concerns and offer alternative payment pathways.

In formulating a policy response to the de-banking problem, it is necessary to know (1) how serious the problem is; (2) what impact de-banking has on the economy and society of each country; and (3) why the problem has occurred. This paper seeks an answer to all three questions. In addition, it reviews the initiatives that have already been taken in some countries, and how effective they have been.

This study therefore entails a stocktake of CBR terminations affecting financial institutions in the following Pacific nations: Cook Islands, Fiji, French Polynesia, Kiribati, Nauru, New Caledonia, Niue, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu. This study includes both an extensive literature review and an assembly of relevant data.

Figure 1: PIF Countries by Population and GDP per Capita, 2021



Sources: World Bank World Development Indicators, Worldometers (https://www.worldometers.info/world-population/niue-population), SPC (https://spc.int/our-members/niue/details), MFEM Cook Islands (https://www.mfem.gov.ck/statistics/134-economic-statistics/national-accounts), World Bank staff estimates.

Figure 1 shows how varied the PIF countries are, both by population and by Gross Domestic Product (GDP) per capita. Four – Nauru, Tuvalu, Niue and Cook Islands – have less than 20,000 people. Only four – Niue, French Polynesia, Cook Islands and New Caledonia – have GDP per capita greater than around US$20,000. Papua New Guinea, with a population of 9.9 million, is home to 77% of all the people in the group of countries.

2.1 De-risking and de-banking[3]

2.1.1 Terminology

Discussions regarding de-risking are complicated by the use of terms that are understood differently by different stakeholders (US Treasury 2023).

"**De-risking**" is defined by the FATF as termination or restriction of business relationships with clients or categories of clients by financial institutions that wish to avoid risk rather than manage it in line with the FATF's risk-based approach (FATF 2014). As the global standard-setter for AML/CFT/CPF, the FATF's definition focuses solely on money laundering, terrorist financing and proliferation financing (ML/FT/PF) risk in their concept of de-risking.

De-risking has been affecting a range of customers, including money remittance businesses, digital currency exchanges, not-for-profit organisations (NPO) and FinTech businesses disproportionally (Eckert et al 2017, De Koker et al 2017, The World Bank Group 2018, US Government Accountability Office 2021, EBA 2022, US Treasury 2023, Select Committee on Australia as a Technology and Financial Centre 2021). CBRs have also been affected extensively by de-risking (CPMI 2016, Starnes et al 2017, Atlantic Council 2022). The discussion of de-risking in relation to certain types of businesses is relevant to de-risking of CBRs as correspondent bank decisions are influenced by the type of clients the respondent bank may have.

Decisions regarding termination and restrictions of business relationships may however not be directly driven by concerns about ML/FT/PF risk. A bank may, for example, be solely concerned about credit risk posed by the customer. Alternatively, a bank may decide to withdraw from a specific region to limit its business to more profitable markets. While risk is a major element of the risk/reward calculus in these cases and may include ML/FT/PF risk, the latter would generally not lie at the heart of the decision. Some stakeholders such as AUSTRAC have been using "**de-banking**" as a broader term to capture terminations or restrictions of business relationships with specific customers or types of customers (AUSTRAC 2023).

2.1.2 Risk and the FATF's risk-based approach

In 2012 the FATF adopted a mandatory risk-based approach. It requires countries to undertake national risk assessments to inform their design of appropriate AML/CFT/CPF regulatory responses to the FATF standards. Where countries identify higher ML/FT/PF risks, they should ensure that their AML/CFT regime adequately addresses such risks. Where countries identify lower ML/TF risks, they may decide to allow simplified measures for some of the FATF Recommendations under certain conditions. Simplification is, however, not available as an option in relation to PF risk as PF risk is informed by rule-based sanctions of the United Nations Security Council (UNSC). Where countries identify a proven low risk, they may allow exemptions from AML/CFT/CPF compliance requirements, as long as full compliance with UNSC sanctions is still required. Many lower capacity jurisdictions

[3] See Technical Paper 1 (TP 1) for a more detailed discussion of de-risking and de-banking.

make some use of regulatory exemptions and regulatory recognition of simplified due diligence in lower risk cases, as allowed by the FATF standards (Celik 2021).

Countries are furthermore required to compel their AML/CFT/CPF-regulated institutions, such as banks, to undertake similar institutional risk assessments to inform the design of proportional institutional compliance responses. At the heart of institutional compliance responses lie measures to determine a customer's identity, to verify that identity, to risk profile the customer, and to monitor the customer's transactions to identify unusual transactions that may need to be reported to the national financial intelligence unit (FATF 2012-2023). These measures are formally called **customer due diligence (CDD)** measures, but are also referred to as **Know Your Customer (KYC)** measures. Where risks are higher, institutions must employ enhanced due diligence measures and, where risks are assessed as lower, they may be allowed to employ simplified due diligence measures.

2.1.3 Risk concepts and approach in practice

The FATF does not define risk for purposes of its risk-based approach (De Koker 2011), but states that "risk can be seen as a function of three factors: threat, vulnerability and consequence" (FATF 2013). In the IMF staff 's terrorist financing methodology, the risk level is formally defined as "the likelihood of successful terrorist financing events in a jurisdiction multiplied by the consequences of the events" (El Khoury 2023).

ML/FT/PF risk assessments generally do not apply rigorous methodologies. The actual assessment of risk is not particularly scientific or necessarily based on sufficient evidence. The FATF, for example, recognises the challenges in assessing the consequences of ML/FT, accepting that "incorporating consequence into risk assessments may not involve particularly sophisticated approaches" (FATF 2013), and in relation to TF risk, advised that "countries need not take a scientific approach when considering consequences, and instead may want to start with the presumption that consequences of FT will be severe (whether domestic or elsewhere) and consider whether there are any factors that would alter that conclusion." (FATF 2019).

Conservative assumptions about consequences will tend to result in higher risk level assessments, even where the likelihood of an ML/FT/PF event is low. Serious and severe consequences are often linked to transactions regardless of the value involved, creating further risk that the risk levels posed by smaller institutions and countries may be assessed as higher than warranted.

Ferwerda and Reuter analysed 11 pre-2020 National Risk Assessments published by eight systemically important countries (Canada, Italy, Japan, the Netherlands, Singapore, Switzerland, the United Kingdom, and the United States) to assess their conceptual understanding and methodologies (Ferwerda and Reuter 2022). They concluded:

> Each raises serious issues regarding the risk assessment methodology. For example, most relied largely on expert opinion, which they solicited in ways that are inconsistent with the well-developed methodology for making use of expert opinion. They misinterpreted data from suspicious activity reports and failed to provide risk assessments relevant for policy makers. Only one described the methodology employed.

Institutional risk assessments, in turn, are informed by national risk assessments. Institutional factors such as compliance culture, business management processes, and concern about fines and penalties, may drive conservative compliance and risk assessment responses at an institutional level too (De Koker and Symington 2014; FATF 2016).

ML/FT/PF risk assessments that may result in de-risking are therefore not necessarily based on objectively verifiable, evidence-based and methodologically sound processes. Some supervisors have indicated that institutions should keep a record of de-risking decisions (EBA 2023, AUSTRAC 2023) and that these may be reviewed (AUSTRAC 2023).

2.1.4 Impact and drivers of de-banking

Generally, all forms of de-banking can impact negatively on development, whether or not they are ML/FT/PF risk-driven. Significant levels of CBR de-banking may create pressure to move financial transactions into the cash economy or compel customers to use unregulated entities. They can worsen hardship in low-income communities by impeding remittance flows or keeping the costs of remittances high. It also increases the risk of crime if it forces transactions into the informal cash-based economy. They risk hampering the unencumbered flow of development funding, as well as humanitarian and disaster relief and can also cause economic damage in strategically important regions if such measures prevent individual remittances from flowing efficiently (US Treasury 2023).

Drivers of de-banking are complex. Most decisions would be driven by risk/reward considerations and ML/FT/PF risk may play a direct or indirect role in some of those decisions (Collin et al 2015, Artingstall et al 2016, Nance et al 2021). One of the major drivers of global de-risking is the increasing burden of compliance with AML/CFT regulations, especially coupled with the reputational risk involved when banks incur large fines for money laundering and terrorism financing offenses that come with negative publicity (RBNZ 2021). Concerns about the profitability of specific relationships are also raised. Changes in business strategies can also be relevant and may, in relation to small jurisdictions and clients transacting in lower amounts, be the dominant driver.

These drivers may of course also be related and intertwined in many cases: AML/CFT/CPF regulation increases compliance costs and decreases profitability of relationships while the risk of fines increases reputational risk. The drivers are also linked to better risk management techniques which allow the measurement of profitability and risks by business line and client relationship.

Further factors at play include the overestimation of risk (discussed further in Technical Paper 1 (TP 1) and the limited use of regulatory exemptions and regulatory recognition of simplified due diligence in lower risk cases, as allowed by the FATF standards (Celik 2021).

2.2 De-risking and CBRs

CBRs have been particularly affected by de-risking as they are relationships that can carry a significant level of ML/FT/PF risk. AUSTRAC describes the concerns as follows (AUSTRAC 2023):

> CBRs are recognised globally as being vulnerable to exploitation for money laundering and terrorism financing (ML/TF) purposes. They involve a financial institution carrying out transactions on behalf of another financial institution's customers, often with very limited information about those end customers.
>
> The correspondent bank often has no direct relationship with the underlying parties to a transaction and is therefore not able to verify their identities. Correspondents often have

> limited information about the nature or purpose of the underlying transactions, particularly when processing electronic payments.

The FATF has clarified that the FATF Recommendations do not require financial institutions to conduct customer due diligence on the customers of their customer (i.e., to identify, verify the identity and profile each individual customer of a respondent bank), a process known as "Know Your Customer's Customer (KYCC). FATF standards require a correspondent bank to monitor transactions with a respondent bank and to consider the quality of the AML/CFT/CPF control measures of a respondent bank. FATF has stated however that: "There is no expectation, intention or requirement for the correspondent institution to conduct customer due diligence on its respondent institution customers" (FATF 2016b).

Regulators such as AUSTRAC and bodies such as US Treasury, however, continue to highlight the risks in correspondent relationships where correspondent banks process payments of direct or indirect customers of the respondent bank and therefore has limited information about the transaction (US Treasury 2023, AUSTRAC 2023).

2.2.1 De-risking: A brief history[4]

Risk-informed terminations of banking services due to ML/FT risk concerns reach back to 2001. In the wake of the 9/11 attacks, global banks exited a significant number of CBRs. In the US, banks responded to the concerns and new regulations by closing accounts of money services businesses, a group of cash handling financial service businesses that include remittance service providers. The closures became so problematic that federal regulatory agencies issued a joint statement on 30 March 2005, acknowledging the problem (FinCEN 2005):

> Money services businesses are losing access to banking services as a result of concerns about regulatory scrutiny, the risks presented by money services business accounts, and the costs and burdens associated with maintaining such accounts. Concerns may stem, in part, from a misperception of the requirements of the Bank Secrecy Act, and the erroneous view that money services businesses present a uniform and unacceptably high risk of money laundering or other illicit activity.

While the supervisory actions stemmed the tide of closures, money services businesses still continued to lose accounts (Bester et al 2008).

Closures of bank accounts of remittance service providers gained global attention in 2014. Public interest was sparked by concern about the closure by Barclays Bank of the account of Dahabshiil, an important international remittance service provider to Somalia. Barclays was the last large UK bank to provide services to Dahabshiil and the closure of its Barclays account threatened the continued flows of UK remittances to Somalia (British Bankers Association 2014, De Koker et al 2017). These concerns led to the FATF's first statements on de-risking (FATF 2014). In October 2015, the UK government launched the Safer Corridor initiative to address the underlying concerns in the UK-Somalia remittance corridor (UK Government 2015).

[4] See Technical Paper 2 (TP 2) for more background on de-risking solutions, including those mentioned in this discussion.

Concerns about the impact of de-risking on CBRs began to escalate in 2014. The FSB expressed particular concern that banks terminating relationships with banks from higher risk countries were creating a real risk of some countries losing their access to the international financial system (FSB 2015). In 2016, the CPMI published its report on correspondent banking (CPMI 2016), with recommendations relating to:

- know-your-customer (KYC) utilities, i.e. collaborative approaches to support client identity verification by regulated institutions;
- use of the G20-suported Legal Entity Identifier (LEI) in correspondent banking and as additional information in payment messages, to ensure that legal entities are easily and uniquely identified and that this information is mapped to the SWIFT-issued Business Identifier Code;
- navigating data protection requirements while increasing information-sharing in correspondent banking; and
- improved payment messages.[5]

The FSB, collaborating with the CPMI, FATF and other standard-setting bodies, also adopted a four-point plan in 2016 that entailed (FSB 2016):

- Further examining the dimensions and implications of the issue;
- Clarifying regulatory expectations, as a matter of priority, including more guidance by the FATF;
- Domestic capacity-building in jurisdictions that are home to affected respondent banks; and
- Strengthening tools for due diligence by correspondent banks.

The FSB's four-point plan has since been subsumed into their joint project with standard-setting bodies and other stakeholders on improved cross-border payments (FSB 2023).

In addition to these de-risking recommendations a range of other, often partially overlapping, recommendations have been made by other bodies, including NPOs, and researchers, addressing broader issues or de-risking of specific customer types (e.g. Starnes et al 2017, Eckert et al 2017, De Koker et al 2017, The World Bank Group 2018, US Government Accountability Office 2021, EBA 2022, Atlantic Council 2022, US Treasury 2023). Specific proposals made and/or initiatives investigated and/or implemented in relation to the Pacific Island countries form the focus of this report, and developments that have been identified as particularly relevant to the Pacific are discussed below and in TP2.

2.3 ML/TF/PF risk in the Pacific

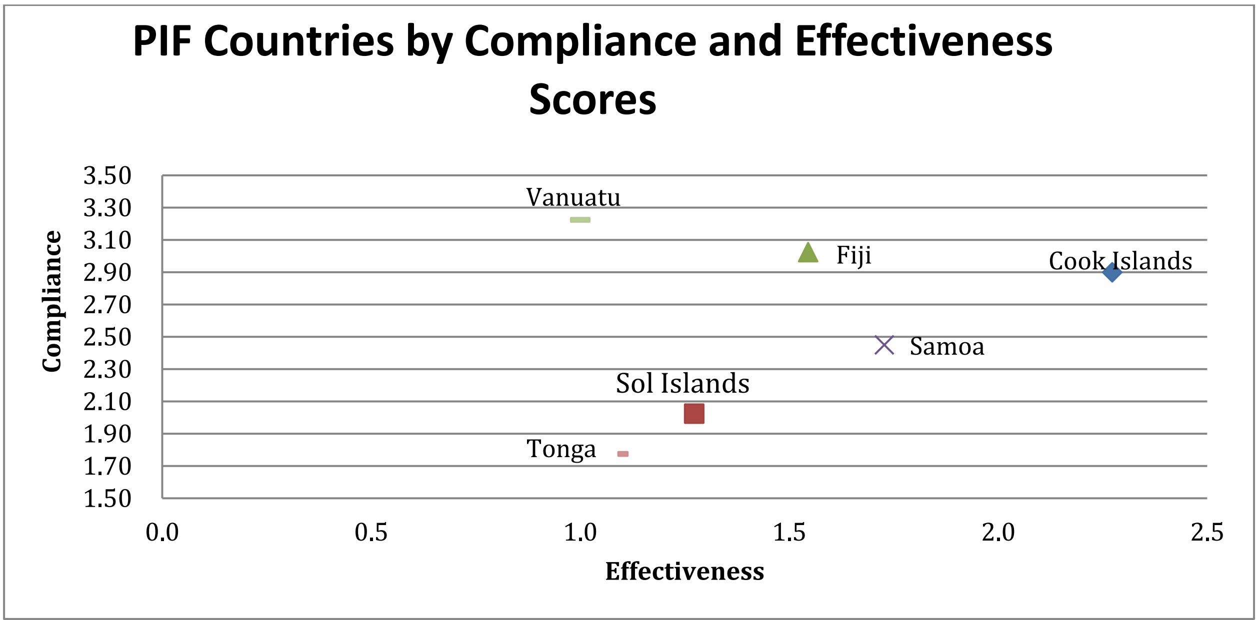
Crime risks vary among the different Pacific jurisdictions and observations at a regional level involve a measure of generalisation. There are, however, some shared characteristics that support a level of generalisation about crime risk.

Perceptions of the level of ML/FT/PF risk in the Pacific depend significantly on the methodology employed to assess risk and on the weight given to the FATF-identified elements of "threat", "vulnerability" and "consequences". As discussed in 2.1.3, risk assessment is not an exact science.

[5] See SWIFT 2023 for the change to ISO 20022 for cross-border payments and reporting.

If "vulnerability" is considered from an FATF-standards perspective, many Pacific jurisdictions are viewed as vulnerable to ML/FT/PF abuse as levels of technical compliance with FATF standards may be low, and levels of effectiveness of implementation of AML/CFT/CPF measures are generally lower than the technical compliance levels. See Figure 2 below for FATF/APG Mutual Evaluation Report (MER) and Follow-Up Report (FUR) results for the third round of mutual evaluations published since 2015.

Figure 2: PIF Third Round FATF/APG MER scores[6]



Source: Table of Ratings for assessment conducted against the 2012 FATF Recommendations, using the 2013 FATF Methodology, updated 30 May 2023, World Bank staff estimates.

However, criminal threat levels in these jurisdictions tend to be also lower than global averages. The Global Initiative Against Organised Crime's *Global Organised Crime Index 2021* (GIAOC 2022) expresses it as follows:

> Looking at the average criminality scores, island states are found to be least afflicted by organized crime by quite some margin, with an average score of 3.67; compare this with landlocked states, which have a score of 4.78, and coastal states, with the highest criminality score (5.33). Of the 20 lowest-scoring countries on the criminality metric, 11 are island states, predominantly those in Oceania.

Criminality scores in relation to organised crime tend to be lower in these jurisdictions as there is generally a limited supply of, and demand for, illicit products given their small economies and populations.

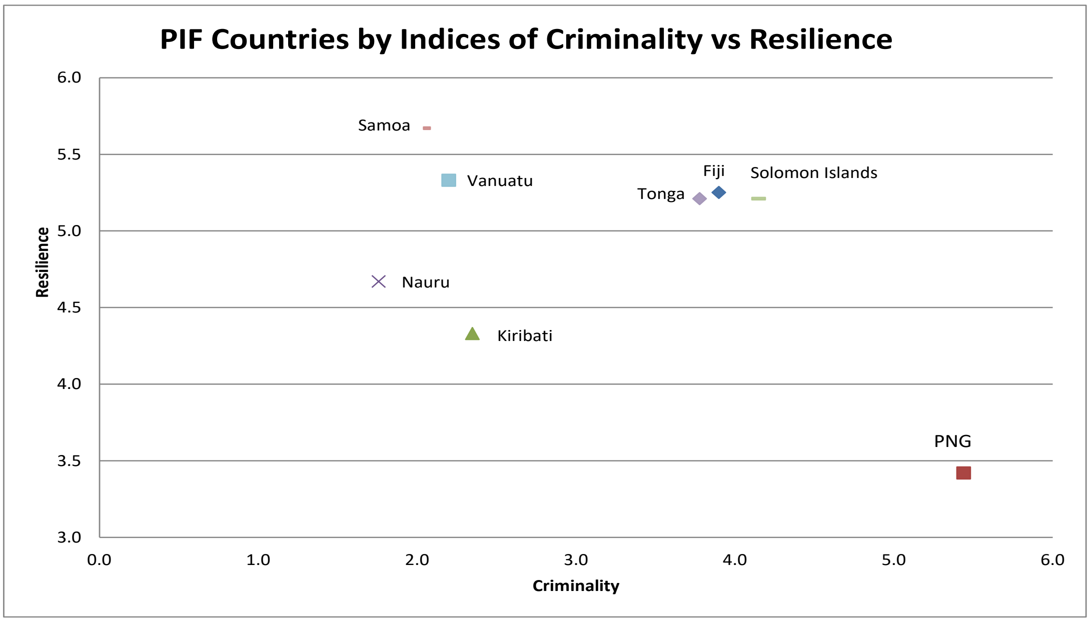
---

[6] Effectiveness scores were calculated by awarding marks as follows to each of the 11 Effectiveness ratings of a country: High (4); Substantial (3); Moderate (2); Low (1). Technical compliance scores were calculated similarly in relation to the forty Technical Compliance ratings: Compliant (4); Largely compliant (3); Partially compliant (2); and Non-compliant (1). The scores for both effectiveness and technical compliance were then averaged, giving each indicator in each set equal weight. A 'composite' indicator, being the simple average of effectiveness and technical compliance indicators, was then computed.

They may, however, be exploited as transit jurisdictions or to hide beneficial ownership. In addition, several Pacific jurisdictions, including Samoa and Vanuatu, have international financial centres with limited disclosure and reporting requirements. Concerns over the opaque nature of these international financial centres has led to the European Union (EU) placing both countries on its list of non-cooperative tax jurisdictions (IMF Mar 2023). The relevance of transit, beneficial ownership or tax abuse to ML/FT/PF risk from a CBR perspective depends, however, on whether, and the extent to which, proceeds of such crimes (and financing in the case of FT/PF) also flow through the financial system of the jurisdiction.

The *Global Organised Crime Index 2021* reflects "criminality" scores for 193 jurisdictions (based on prevalence of criminal markets and the structure and influence of criminal actors) and "resilience" scores for each (reflecting the existence, capacity and effectiveness of country responses to organized crime based on 12 factors, including AML/CFT). Figure 3reflects the scores for Pacific jurisdictions included in the Index. The figure shows three distinct clusters. Firstly Samoa, Nauru, Vanuatu and Kiribati have an average criminality index of around 2 and a resilience index of around 5. A second group that comprises Tonga, Fiji and Solomon Islands have a similar level of resilience (an average of just over 5) but greater score on the criminality index (an average of around 4). PNG is less resilient, with a resilience index of 3.4, and has a higher criminality index score of 5.4.

Figure 3: Global Organised Crime Index 2021: Selected Pacific Island Jurisdictions



Sources: Global Organised Crime Index 2021, World Bank staff analysis

The value of proceeds available to be laundered is an important element of ML threat. Some significant crime types, however, may not produce significant levels of proceeds of crime. Studies reflect grounds for concern about corruption in Pacific jurisdictions (Hopkins & Le Nguyen 2022) but the majority of cases appear to involve petty corruption. These would tend to generate limited proceeds of crime to be laundered. The National Anti-Money Laundering Council of Fiji's 2020 report on *Money Laundering Threats in Fiji* analysed the value of proceeds of crime generated by major crimes in Fiji (GDP US$ 4.3 billion). A summary is shown in Figure 4 below. These values could be compared to proceeds of crime in Australia (GDP USD 1.55 trillion), estimated at AU$53 billion for 2020-1 (1 AU$ = US$.67) (Smith & Hickman 2022).

Figure 3: Estimated value of illicit proceeds laundered in and through Fiji annually by major crime type (1 FJ$ = .45 US$)

Very large: (more than FJ$10 million)	• Tax Evasion, Tax Fraud and Related Offences (e.g. with an estimated FJ$ 250m or more annually lost in VAT revenue) • Drug Related Offences (Import, Cultivation, Manufacture, Trafficking (e.g. with marijuana with a of FJ$ 68 million seized in 2018)
Medium (FJ$500,000 – FJ$5 million)	• Corruption, Bribery and related offences • Robbery & Theft • Fraud & Forgery • Environmental Crime (Illegal Fishing, Illegal Logging etc)
Small (FJ$100,000 – FJ$500,000)	• Human Trafficking • Piracy & Copyright Offences • Counterfeiting and Piracy of Products
Very small (less than FJ$100,000)	• Counterfeiting Currency

Lower resilience levels in a Pacific jurisdiction may mean that a number of transactions involving illicit funds in relatively small values can flow unchecked through their financial systems, compared to larger economies. In the latter, however, much higher value transactions can be concluded when they slip through the AML/CFT/CPF net. Standard ML/FT/PF risk assessments are not specifically designed to weigh the different risks posed by these jurisdictions comparatively, especially in relation to FT/PF risk. The IMF/World Bank draft remittance corridor study discussed in 2.3.1 below may improve the risk analysis in this regard.

Notwithstanding the level of crime risk, Pacific jurisdiction are subject to international obligations to ensure that their AML/CFT/CPF regimes meet global standards. Failure to do so put international investment and CBRs at risk and may in time increase targeting of these jurisdictions and their populations by international organised crime.

2.3.1 Remittance corridor risk assessments

Two Pacific remittance corridor studies have been undertaken, by AUSTRAC (2017) and by the New Zealand Department of Internal Affairs (2021). Both studies were uni-directional and focused on the significant remittance flows from Australia and New Zealand to the Pacific Islands through non-bank money remitters. AUSTRAC concluded the overall ML/TF risk for these remittances is low, while the New Zealand study concluded that while the overall level of inherent ML/TF risk for the sub-sector is medium, low value (under NZ $1,000) remittance transactions from the Pacific Island diaspora or seasonal workers to the Pacific Islands for family support, and familial or cultural events, are assessed to be of low inherent ML/TF risk.

As part of the FSB's G20 Roadmap for Enhancing Cross-border Payments project (FSB 2023), the IMF and the World Bank were assigned to develop a framework for remittance corridor' risk assessments, as part of Building Block 7 on "safe payment corridors". IMF and World Bank staff published a draft *Framework for Money Laundering/Terrorist Financing Risk Assessment of a Remittance Corridor* in October 2021 (IMF/World Bank 2021). The draft framework, which was informed by the earlier Pacific corridor studies, is to be tested in pilot assessments before it will be finalised.

The draft methodology advises assessors to differentiate between national ML/FT risk and the risk of criminal abuse of a particular corridor and the risk of abuse of specific remittance products and services within that corridor. High tax evasion risks, for example, may not translate into a high risk of abuse of a remittance corridor to transfer proceeds of tax evasion. Similarly, not all national AML/CFT vulnerabilities, e.g. lack of beneficial ownership transparency, may, depending on the main users, not have a direct bearing on the remittance corridor. The methodology suggests that assessors may view lower value ML transactions as holding lower ML consequences. The same is not possible in relation to financing of terrorism, but assessors can consider where a potential transaction may fit into a financing chain and the potential application of such funds in the particular corridor to consider the gravity of any consequences. Assessors are also guided to consider the impact consequences of an ML/FT risk event on the reputation of financial institutions, as there may be no negative consequences (e.g., reputational or pecuniary) for the financial institutions that facilitated the remittances if the required ML/TF measures were applied appropriately. Assessors are also advised to consider the ML/FT impact of overly-conservative approaches, e.g. where funds may be pushed into the informal economy.

The draft methodology does not extend to CPF risk assessment, but this should be added in due course.

3 Recent developments of relevance to the Pacific

In 2021 the FATF launched a project to investigate the unintended consequences of the FATF standards, including de-risking (FATF 2022). Following that work, the FATF resolved to take a closer look at unintended consequences relating to NPOs and financial inclusion. Work on improved guidance relating to the assessment of risks posed by NPOs and potential changes to the FATF standards is being undertaken at the moment, while further work on financial inclusion is pencilled in to commence later in 2023.

At the request of the G20, the FSB developed the G20 Roadmap for Enhancing Cross-border Payments (FSB 2020). See Figure 2 of TP 2 for an overview of the Roadmap. This project is being undertaken in coordination with the CPMI and other relevant international organisations and standard-setting bodies, including the FATF (FSB 2023). The Roadmap incorporates the FSB's work since 2015 to address de-risking and the decline in CBRs and financial access by remitters. Building Block 19 of the roadmap focuses on investigation of cross-border use of Central Bank Digital Currencies (CBDCs). Depending on design, CBDCs may at a future stage be able to address many of the frictions and inefficiencies in current CBR-reliant cross-border payment systems (BIS 2022). However, the concept gives rise to too many questions and risks to afford a reasonable solution for Pacific CBR challenges in the short term. Importantly, as discussed in 2.3, the IMF and the World Bank developed a framework for remittance corridor risk assessments, as part of the Roadmap's Building Block 7 on "safe payment corridors" (IMF/World Bank 2021). The draft framework, which was informed by the earlier Pacific corridor studies, is to be tested in pilot assessments before it will be finalised. The IMF and the World Bank have approached Pacific Islands with an invitation to join in a piloting of the draft assessment methodology.

In April 2023 the US Department of Treasury, as mandated by the Anti-Money Laundering Act of 2020, published its first de-risking strategy. The strategy report examines the phenomenon of financial institutions de-risking and its causes, and it identifies those that face the greatest impact. It also offers recommendations to combat it, including the expansion of international cooperation and consideration of creative options, such as regional consolidation projects with international counterparts, to address the decline in CBRs, especially for small foreign banks.

On 31 March 2023, EBA published guidelines to address 'unwarranted' de-risking and ensure that customers have access to the financial services they need to participate in society (EBA 2023a). The guidelines stipulate steps that financial institutions should take when considering refusing or terminating a relationship with a customer based on AML/CFT compliance reasons and policies, procedures and controls that credit and financial institutions maintain to facilitate access to financial services by those categories of customers that the EBA highlighted as vulnerable to unwarranted de-risking (EBA 2023b). While these measures may not apply directly to CBRs, they will probably impact on the way in which European banks manage de-risking decisions in general.

The Caribbean region is similarly concerned about the impact of correspondent bank de-risking. The Atlantic Council has been studying the problem (Atlantic Council 2022) and in September 2022 the Committee on Financial Services of the US Congress held hearings on the loss of CBRs with the Caribbean (Committee on Financial Services of the US Congress 2022). While the regions have very different contexts, it may be beneficial to discuss the shared challenges and experiences with others.

In June 2023 AUSTRAC published new de-banking guidance relating to higher risk customers, including FinTechs. The guidance is intended to (AUSTRAC 2023):

- help financial institutions understand AUSTRAC's expectations when providing designated services to businesses they consider 'higher-risk'.
- encourage businesses in affected sectors to engage openly with financial institutions and provide the type of information they may request, to demonstrate the steps they are taking to address risks within their particular business.

The AUSTRAC guidance does not address CBRs explicitly, but it will likely impact on the risk assessment and management of CBRs by Australian banks.

The Pacific Islands Regional Initiative (PIRI), a working group of the Alliance for Financial Inclusion, adopted a Pacific Islands Regional De-Risking Action Plan in May 2019. The plan was developed further in 2020 and 2021 with diagnostic reports on some PIRI members and a coordination strategy. The action plan includes the following (PIRI 2021b):

1. Inter-regulator and stakeholder coordination
   - Establish a coordination mechanism to drive the implementation of the action plan and its national-level iterations.
   - Strengthen engagement and coordination among key stakeholders, including through enhanced engagement with Australia, New Zealand and the USbanks, regulators and AML/CFT supervisors.
2. Diagnostics and monitoring frameworks to track implementation progress
   - Promote effective data collection and analysis, including diagnostic studies to accurately inform the development of a coordinated regional and national response to address de-risking and to track implementation progress.
   - Facilitate a data- and information-sharing mechanism between key stakeholders.

3 Compliance with AML/CFT standards and risk assessment

- Enhance national capacity building to improve AML/ CFT compliance and supervision.
- Strengthen implementation of risk-based AML/ CFT measures in the Pacific region.

4 Technology-based solutions

- Explore the use of FinTech and regulatory technology (RegTech) solutions as well as innovative regulatory approaches, such as innovation hubs, national sandboxes and the PIRI Regional Regulatory Sandbox.
- Enable initiatives that leverage the deployment of technology-based solutions.

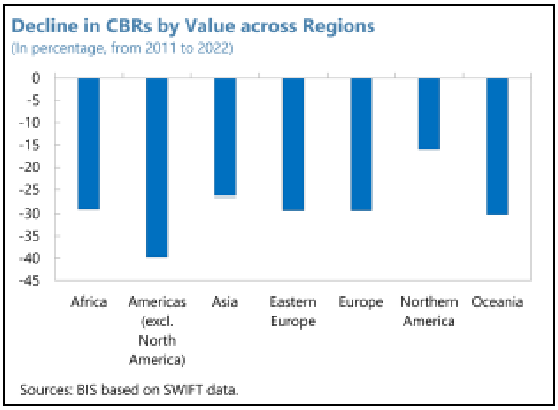
Current PIRI members are Banco Central Timor Leste; Bank of Papua New Guinea; Central Bank of Samoa; Central Bank of Seychelles; Central Bank of Solomon Islands; National Reserve Bank of Tonga; Reserve Bank of Fiji; and Reserve Bank of Vanuatu.

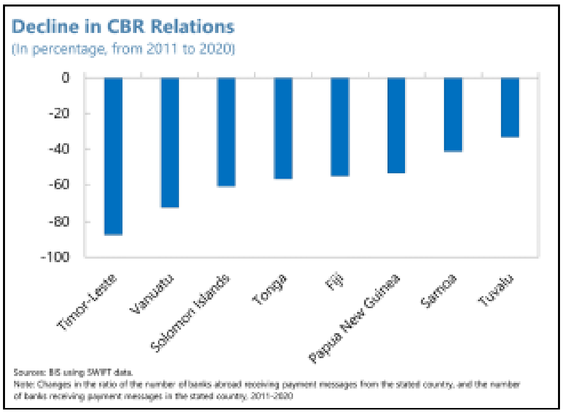
4 The extent of CBR decline in the Pacific

The extent to which CBR have been withdrawn from PIF countries is recorded in data held by SWIFT. However, SWIFT does not publish these data on an individual country basis and has so far refused to make them available for this study. The data for an individual country can be requested by the relevant Central Bank, but SWIFT does not allow t the data to be passed on to third parties.

SWIFT has however released limited data for some countries, through the CPMI of the BIS, on four occasions, in 2023, 2020, 2019 and 2018. This does not provide year-by-year information for individual countries, but rather a single number for how much of a decline there had been since 2011. Using these data, a March 2023 IMF Article IV study reported on the loss of CBRs by region and by countries within the Oceania region (IMF Mar 2023), as shown in Figure 5.

Figure 5: IMF estimates of decline in CBRs

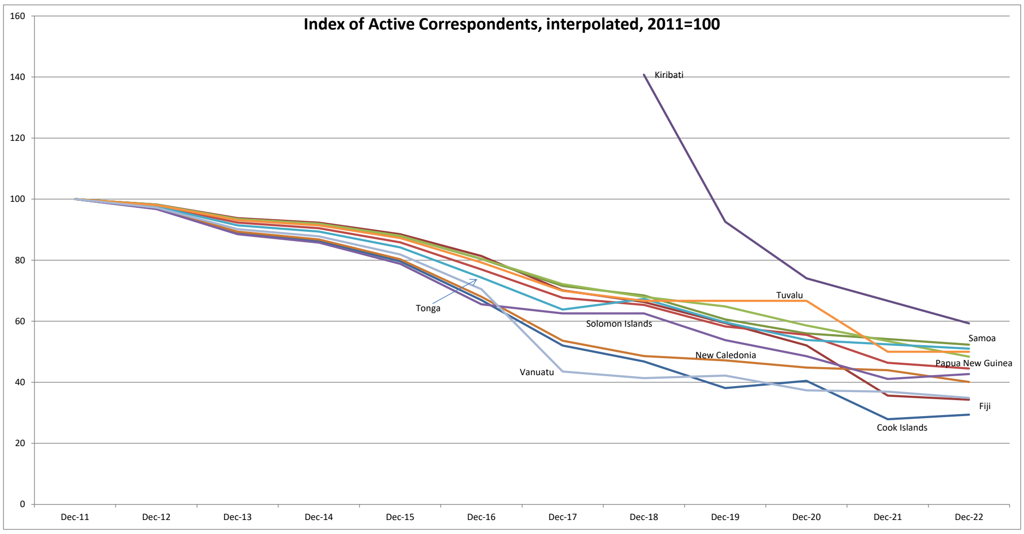




Source: IMF March 2023

On one occasion, SWIFT has also provided detailed information for the number of active correspondents in six countries that are members of the Alliance for Financial Inclusion's PIRI initiative for the years 2016 to 2019 (the 'PIRI' data). The CPMI information also provides year-by-year information for the region of Oceania (which includes Australia and New Zealand). Interpolation and comparison between countries has been used to prepare a table of 'best estimates' of the pattern of CBR decline for the PIF countries in the period 2011-2022, presented in Figure 6.

Figure 6: Index of Active Correspondents, interpolated, 2011=100



Source: SWIFT data, presented through CPMI and PIRI, World Bank staff estimates

SWIFT also provided some limited information through CPMI on how the number and value of transactions has changed since 2011, but did not provide a time series. Table 1 shows that all countries have increased the number of transactions (through a reduced number of channels), and several have increased the value of transactions.

Table 1: SWIFT data on changes to number and value of transactions through CBRs

	2022/2011	Changes %
	cumul_trans	cumul_val
Cook Islands	8.90	–86.8
Fiji	42.50	61.20
French Polynesia	46.90	–10.6
Kiribati	67.70	13,297.70
Nauru		
New Caledonia	0.10	–15.9
Niue		
Papua New Guinea	126.20	–26.0
Samoa	39.10	278.30
Solomon Islands	30.20	641.30
Tonga	27.80	–33.4
Tuvalu	30.20	91.00
Vanuatu	38.00	13.70

Source: SWIFT data, presented through CPMI

Note: The figures in the table above show the percentage change over the period 2011-2022, so the number '8.90' for the Cook Islands, for example, means that cumulative transactions rose 8.9% over that whole period, and the number -86.8 means that cumulative value fell by 86.8%%, again over the whole period.

Econometric analysis by Rice et al found that countries that stood out in terms of corruption and deficient AML/CFT compliance suffered the greatest decline in active CBRs. Countries with a longer history of AML/CFT deficiencies lost more active correspondents than the average, and a higher perceived corruption score accelerated the decline of CBRs (Rice et al 2020)). The analysis also found that stronger growth in trade and macroeconomic performance helped to maintain CBRs.

4.1.1 Changes in countries' CBRs and policy considerations

Table 2 shows the change in number of CBRs, cross border transaction values and local banks between 2011 and 2022, for the countries for whom CPMI publish data. The table shows that all countries have suffered significant reductions in the number of CBRs, ranging from a decrease of 40% for Kiribati to a decrease of 70% for the Cook Islands. The CPMI data does not, however, provide information on the total number of correspondent banks providing services to each country. While large decreases are a source of concern, most worrisome is the situation of the countries that are left with few remaining CBRs.

Table 2: Changes in CBRs, transaction values and local banks 2011 – 2022

	CBR (counterparties abroad) (% Change 2011 to 2022)	Cumulative transaction value (% Change 2011 to 2022)	Local banks (% Change 2011 to 2022)	Number of local banks in 2023
Cook Islands	-70.6 %	-86.8 %	0.0 %	4
Fiji	-65.7%	61.2%	16.7%	6
French Polynesia	-47.7%	-10.6%	0.0%	5
Kiribati	-40.7%	13297.7%	0.0%	2
New Caledonia	-59.9%	-15.9%	0.0%	5
PNG	-55.5%	-26.0%	20%	4
Samoa	-51.6%	278.3%	0.0%	4
Solomon Islands	-57.3%	641.3%	25.0%	4
Tonga	-49.0%	-33.4%	25.0%	4
Tuvalu	-50.0%	91.0%	0.0%	2
Vanuatu	-65.1%	13.7%	33.3%	6

Source: CPMI 2023 and World Bank staff investigation

The need for better information on the extent of CBR closures, and the extent of issues perceived by individual countries is a constant refrain amongst the recommendations discussed in TP2. This report recommends that a framework or “dashboard” be developed which classifies the status of de-banking in individual countries according to agreed criteria, including in relation to a country-specific CBR de-banking resilience criteria. Such a framework could be developed by an international agency, such as the World Bank or the IMF. In the meantime, it is possible to glean some indication of the vulnerability of individual countries from public sources, such as IMF Article IV reports, other published materials and the responses to the survey (reported in TP5).

Table 3 provides an illustrative dashboard using publicly available information.

***Table 3:* Illustrative dashboard for PI Forum Countries**

	Status	Source	Date	Notes
Cook Islands	No information			
Fiji	No issue	IMF Article IV	Dec 2021	Fiji does not appear to be facing significant pressure on CBRs (IMF Dec 2021, Davies 2023)
French Polynesia	No information			
Kiribati	No issue	IMF Article IV Mission	Feb 2023	Awaiting publication of findings
Nauru	Some issues	IMF Article IV	Feb 2022	Limited ability to undertake international transactions in non-AUD currencies. Significant exchange rate-induced revenue losses
New Caledonia	No information			
Niue	No information			
PNG	No issue	IMF Article IV Survey	Sep 2022 2023	Working to minimise risks of possible future disruptions to correspondent banking services by strengthening their AML/CFT framework and broader regulatory arrangements; also taking regulatory action against a local bank to demonstrate the importance of compliance with AML/CFT rules (IMF Sep 2022, Davies 2023) Bank of China opened a representative office in June 2023 (Oeka 2023).
Samoa	Some Issues	IMF Article IV	Mar 2021	The two domestic banks had their USD CBRs terminated in 2021. Continues to face pressures on CBRs in its domestic banks with factors including low profitability, weaknesses around AML/CFT supervision and reputational risks from Samoa offshore sector weighing on the provision of those services (IMF Mar 2023a, Davies 2023).
Solomon Islands	Some Issues	IMF Article IV	Jan 2022	CBRs under some muted pressure for past several years, in part because most commercial banks are subsidiaries of foreign banks. AML/CFT framework is being strengthened (IMF May 2023, Davies 2023)
Tonga	Some Issues	IMF Article IV Survey	Aug 2020 2023	Loss of CBRs seen as important downside risk with two smaller banks recently losing their USD accounts (IMF Aug 2022, Davies 2023).
Tuvalu	Vulnerable	IMF Article IV Survey	July 2023 2023	Tuvalu currently maintains 3 CBRs, after losing a CBR in 2020 (IMF July 2023). In March 2023, Tuvalu had 1 CBR left (IMF Article IV, Vanuatu, Annex VIII)
Vanuatu	Some Issues	IMF Article IV	Mar 23	Continues to experience some pressure on CBRs, with domestic banks most affected. Causes include concerns around AML/CFT framework, economic citizenship program, offshore financial centres and tax transparency (IMF Mar 2023, Davies 2023).

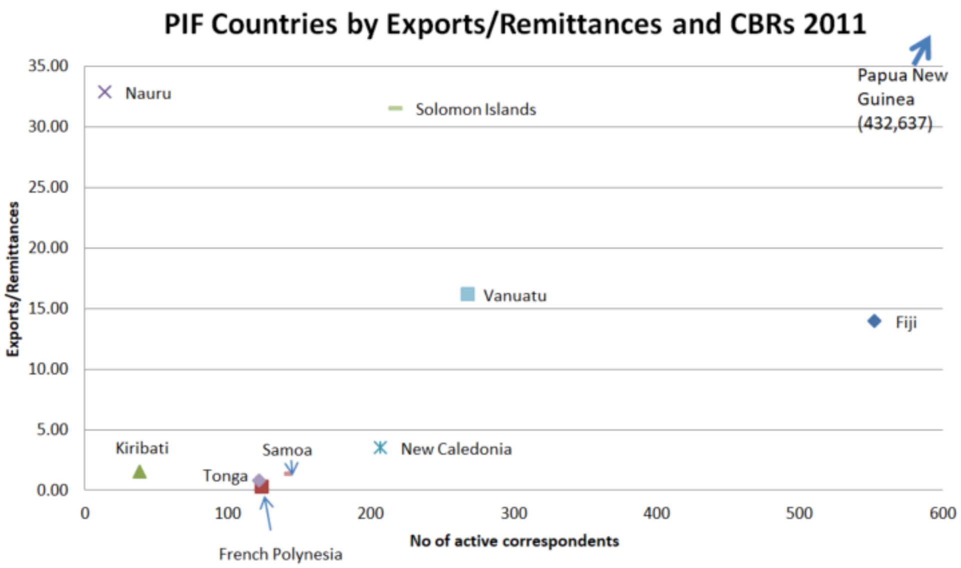
When analysing the appropriate policy responses, the IMF proposed classifying solution initiatives according to the two key drivers of CBR losses identified above: the extent of AML/CFT risk and the commercial viability of providing CBR services (IMF, Becker 2023b). Thus a matrix with two dimension is identified:

- Low value versus high value transactions, on the basis that low value transactions such as remittances tend to be much less vulnerable to AML risk. Conversely, countries with high value transactions are likely to be perceived as higher risk so that better/more transparent compliance activity becomes more important. It is also suggested that a useful measure for this purpose is the ratio of exports to remittances.
- Low versus high existing connectivity (i.e. number of existing CBRs). Low connectivity tends to be associated a lack of economies of scale and/or financial infrastructure. Notably, evidence that suggested that countries that have limited economies of scale tend to be further disadvantaged by less robust financial sectors was found.

Note however that while the FATF views lower value transactions as posing a lower ML risk, they may still pose a higher risk for TF purposes. Value is furthermore not relevant in relation to proliferation financing and sanctions risks.

At the beginning of our data period (2011), Figure 7 shows that five of the countries with relevant data had an exports/remittances measure below 5, Vanuatu and Fiji were around 15, Nauru and Solomon Islands just over 30. PNG is an outlier in terms of size of economy and number of correspondents, Fiji an outlier in terms of number of correspondents.

Figure 4: **Clustering of PIF Countries in 2011**

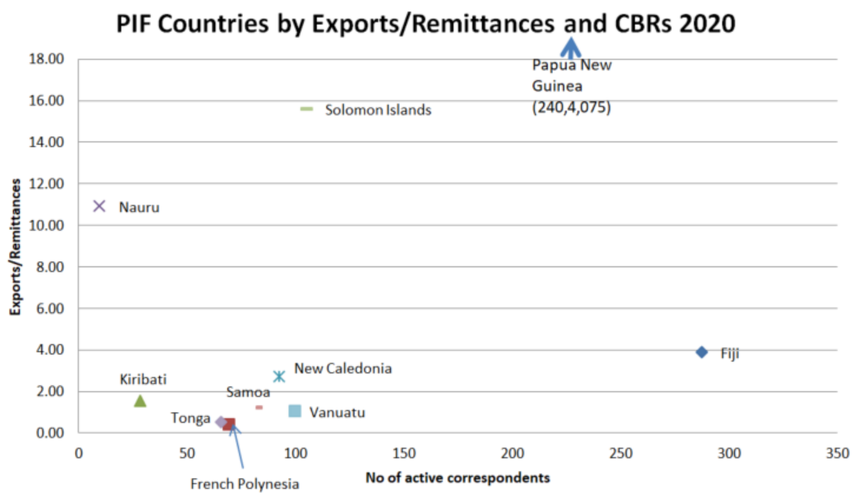


Sources: World Development Indicators Database, SWIFT (as presented through CPMI and PIRI), Observatory of Economic Complexity, World Bank staff estimates

Note: The ratio of exports to remittances for PNG was off the scale, at 432,637.

At the end of our data period, although there has been a general fall in the number of CBRs, and in the level of exposure, the relative picture has not changed much, with the number of Nauru and Solomon Islands declining and Vanuatu becoming more vulnerable.

Figure 5: Clustering of PIF Countries in 2020



Sources: World Development Indicators Database, SWIFT (as presented through CPMI and PIRI), Observatory of Economic Complexity, World Bank staff estimates

Figure 5 provides a similar cluster analysis of PIF countries for 2020. It seems that, on these measures, it might be useful to cluster Kiribati, Tonga, Samoa, New Caledonia, French Polynesia and Vanuatu together to consider urgent CBR solutions. Fiji is different in that it has a particularly well-developed financial sector. Nauru, Solomon Islands and Papua New Guinea have a much higher ratio of exports to remittances.

4.1.2 Survey of PIF Countries

In order to establish the current situation with regard to Correspondent Banking in each of the PIF countries, and to seek views on important issues and appropriate responses, a survey was created. The survey was initially circulated by the PIF to members on April 4th, with a request to respond by April 28th. Only one country responded by the deadline. Various follow up requests were made by World Bank officials, which led to Country 2 responding with a preliminary and then a follow-up response, on May 2nd and May 4th. After some further prompting, Country 3 responded on May 16th. No other responses have been received at the time of writing.2023. None of the three countries were able to provide SWIFT data due to SWIFT data sharing restrictions. The full survey and detailed responses are reported in TP 5.

There was some difference between the responses. Both Country 1 and Country 3 felt that the loss of CBRs had had a significant impact. Country 2 said there was no discernible impact, and that banking relationships were proceeding according to license conditions, with few problems. Country 1 reported that technology had not helped with the problems, while Country 3 reported success with the use of a virtual correspondent bank. Both Country 1 and Country 3 said that the decline in CBRs had delayed transactions, both for international finance and trade, and raised costs. Country 2 put the problems they faced down to structural issues in their economy, rather than to the decline in CBRs.

5 Impact of decline in CBRs on exports

To explore what can be said about whether the decline in CBR has affected exports, a database was created for all the PIF countries, which has exports/GDP as a dependant variable, and a range of possible independent variables which may help to explain the variance observed. These variables include, as well as our CBR indicator, a COVID dummy (in the years 2020 and 2021), an indicator of the impact and strength of natural disasters, an exchange rate index, a measure of the average growth of the five largest trading partners for each country, and a measure of the average commodity price movement for the main exports of each country.

The methodology used for this purpose follows one that was employed in analysing the impact of FATF greylisting (De Koker, Howell and Morris 2023). This used a 'pooled cross-section time series' approach, which aims to establish a statistical relationship between the dependent variable (in this case change in exports as a share of GDP , normalised for size of country) and suitable explanatory variables (such as the decline in the number of unique correspondent banking counterparties). TP 6 provides sources and methods, and detailed econometric results.

A strongly significant negative coefficient for the change in CBR was found, providing evidence that the decline in CBR has had an impact on export performance. Intuitively plausible coefficients for average growth rates of trading partners and average price of exported commodities were also found, though less significant.

6 Impact of decline of CBRs on remittance costs

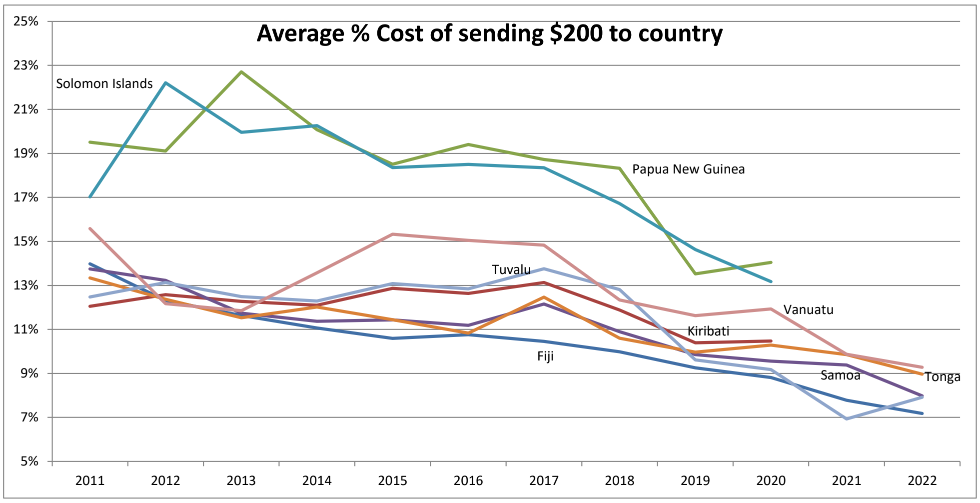
Data on the cost of incoming remittances is provided for four PIF countries (Fiji, Samoa, Tonga and Vanuatu) in the World Bank's Remittance Cost database for the period from 2011 onwards. This is based on a survey of remittances, believed to be reasonably representative of transactions carried out by individuals, and standardised on transfer of US$200 equivalent, from anywhere in the world. In addition, Saver Global have assembled data for this study for eight PIF countries[7] for transfers from Australia (of A$200) and New Zealand (of NZ$200) for the period from 2010 onwards. Figure 6 takes a weighted average of all entries in the database[8] for the relevant country in each calendar year. The average cost includes fees and the difference in exchange rate between that charged and the interbank rate.

The period of steep rise in costs in Vanuatu coincided with the period when Vanuatu was being 'greylisted' by FATF.

[7] Fiji, Tonga, Samoa and Vanuatu, plus Kiribati, Papua New Guinea, Solomon Islands and Tuvalu.

[8] The World Bank data also includes observations for Kiribati, Papua New Guinea, Solomon Islands and Tuvalu for 2011 only. In total, the World Bank data comprises 6,704 observations from 2011 to 2022, the Saver Global data 8,311 observations from 2010 to 2022.

Figure 6: Average Remittance Costs in PIF Countries (Percentage of $200 equivalent)



Source: World Bank Remittances Database, Saver Global Database, World Bank staff estimates

TP 6 includes a more detailed analysis of these data sources. It shows, in particular, that the decline in costs may be partly explained by a shift in the channels that are used to process remittance transfers, for example towards online and 'mobile money', and also by an increase in the market share of money transfer operators (MTOs).

However, despite these changes, remittance costs are still considerably higher in PIF countries than they are in, for example, SE Asia or South Asia, as shown in Table 2.

Table 2: Remittance costs in PIF Countries compared to SE and S Asia

	2011	2016	2022
Fiji	13.6%	9.7%	7.4%
Samoa	12.1%	10.6%	7.5%
Tonga	12.8%	10.7%	8.8%
Vanuatu	13.3%	14.6%	9.1%
Indonesia	6.4%	7.6%	5.5%
Malaysia	6.5%	8.3%	5.4%
Philippines	6.1%	5.8%	4.1%
Thailand	8.3%	10.1%	6.4%
Bangladesh	4.1%	4.1%	4.3%
India	7.8%	6.4%	4.8%
Nepal	5.2%	4.3%	3.7%
Pakistan	7.5%	4.8%	3.7%
Sri Lanka	5.7%	5.3%	4.2%

Source: World Bank Remittances Database, World Bank staff estimates

Sustainability Development Goal SDG 10.c “commits, by 2030, to reduce to less than 3 per cent the transaction costs of migrant remittances and eliminate remittance corridors with costs higher than 5 per cent.”

TP 6 also reports econometric analysis which explores whether the variance in remittance costs can be explained by a combination of changes in the number of CBRs (normalised to size of country by GDP), the presence of international banks (as reflected in BIS claims data), and by increases in the share of more technological remittance channels. A negative coefficient on the change in CBRs was found, meaning that a decline in CBRs has an upward effect on remittance costs. However, the coefficient is only barely significant, so no robust conclusion can be drawn from this analysis. Most of the other variables have expected signs: a reduction in local banks (thus reducing competition in the banking industry) also has an upward effect on remittance costs; a wider spread (again indicating reduced competition) is related to an increase in costs; and a greater use of technology reduces remittance costs.

7 Policy suggestions made to date

In the past ten years CBR terminations, restrictions and refusals were the subject of a range of studies and actions globally as well as in the Pacific. These are discussed in greater detail in TP 2.

When looking at the range of initiatives proposed in response to de-risking in the Pacific, it is important to recognise that, just as there are several factors contributing to the scale and impact of de-risking, so there are a range of types of solutions, and no single solution will solve the problem for all countries, or indeed any individual country (IMF 2023, Department of Treasury 2023).

The Reserve Bank of New Zealand noted that recommendations for addressing de-risking have tended to be made along four key dimensions (RBNZ 2021):

a) Better awareness, monitoring and information sharing
b) Improving AML/CFT risk-management and know-your-customer (KYC) capabilities for respondent banks
c) Clear articulation and enforcement of a risk-based approach to AML/CFT regulation
d) Development of technology-based solutions to support payments and remittance flows

The difficulty with this categorisation is that it is not exhaustive or mutually exclusive: technology-based solutions can contribute to other areas, such as KYC capabilities, some initiatives could fall into both b) and c) above, and it doesn’t cover the de-banking that has occurred as a result of the reduction in financial viability of CBR services.

TP 2 summarises the existing literature and attempts a collation and discussion of the many suggestions that have been made. TP 4 presents a stocktake of the initiatives that are being undertaken or investigated by PIF members. In doing so, it uses the following classification of solution initiatives:

a) Improving ML/FT/PF risk management
    - Better data
    - Better regulation
    - Better AML/CFT/CPF capacity
b) Improving the enabling environment for CBR services
    - Supporting digital financial services

- Improving national infrastructure
- Adopting regional/shared solutions

c) Countering the effects of complete loss of CBRs directly

Solutions do not necessarily fit neatly into this framework, but it provides a workable structure for purposes of the stocktake.

The stocktake also identifies with whom the responsibility lies for implementing each solution initiative. Here the choices include the FATF, the Asia Pacific Group on Money Laundering (APG), other global institutions such as the IMF, Pacific Island governments/key institutions/regulatory bodies, supra-national bodies such as the PIF, correspondent banks, local banks, other financial institutions including MTOs, and remitting clients such as NPOs.

Technological solutions clearly have an important role to play, but one that cuts across more than one classification. Accordingly, while technological solutions are identified, they are not classified separately.

Identification of the actions that should be listed is complicated by the range of factors that may directly or indirectly inform de-banking decisions. The report therefore focuses on actions that are generally viewed as directly linked to de-banking.

Early discussion of recommendations to counter the loss of CBRs focussed on the need to upgrade compliance, through a combination of upgrading supervisory frameworks and allaying the concerns of correspondent banks by improving domestic compliance with AML/CFT regulations (Artingstall 2016, Alwazir et al 2017). In making these recommendations, the potential for technology to reduce the costs at the same time as improving the extent of compliance was recognised (World Bank 2018, Davidovic et al 2019). However, as de-banking has continued, and with the tendency of CBRs to fall at a faster rate and to lower absolute numbers in smaller nations, including the PIF members, policy recommendations were widened to include what measures can be taken to improve the commercial viability of providing CBR services and/or mitigate the effect on vulnerable countries/remitters (IMF March 2017, IMF Sep 2021). Consideration has turned also to whether FATF standards are unintentionally contributing to inappropriate de-risking and how these might be addressed (FATF 2022).

TP 2 provides a detailed discussion of the numerous policy suggestions that have been made, and provides references and discussion. The following summarises the main recommendations that have been made in the international literature.

7.1 Improving ML/FT/PF risk management

7.1.1 Better Data

Under the category of better data, the key recommendations made to date can be summarised as:

- Collecting data on CBR closures
- Improved collection of statistics of financial sector data in general
- Provision of more Pacific ML/FT/PF risk data to inform improved risk assessments by international banks (e.g. corridor studies; country risk assessments)
- Improved regional dialogues/information flows
- Improving public-private risk information sharing

The World Bank, US Department of Treasury and IMF have all called for systematic collection and management of data on CBR closures and related matters. The US Government Accountability Office (GAO) , AUSTRAC, DFAT and various academic commentators have called for more Pacific ML/FT/PF risk data to inform improved risk assessments by international banks (e.g. corridor studies; country risk assessments). PIRI responded by adopting improved data collection as part of its de-risking action plan (PIRI 2021).

As noted above, SWIFT does in fact hold data on CBRs which would be useful to PIF Members, but it does not make this generally available.

The World Bank has recommended forums and regular events to enable banks and others to share information and progress, so that foreign correspondent banks understand the country context and risks. More guidance in the form of country or corridor assessments would also assist banks in managing risks.

To further advance understanding of AML/CFT/CPF risks by bank examiners, the US Treasury recommended that money service businesses be allowed to share US federal and/or state examination results with their banking partners (Department of Treasury 2023).

The US Treasury has recommended the establishment and support of formal multi-stakeholder, public-private, domestic and international fora on the causes of de-risking, consequences and collaborative solutions (Department of Treasury 2023).

7.1.2 Better Regulation

The potential solutions that have been recommended under Better Regulation cover:

- Appropriate risk-based customer due diligence frameworks
- Enabling eKYC implementation to support remote onboarding
- Considering correspondent banking safe harbour provisions for lower risk jurisdictions

AML/CFT/CPF regulatory frameworks should be risk-based and allow for customer due diligence to be simplified where risks are lower. Tiered-based CDD may be an appropriate regulatory option to implement (Celik 2021).

Enabling frameworks for **eKYC** are also important, i.e. using electronic identity data rather than documents for KYC purposes. KYC rules should, for example, allow institutions to use data to verify a customer and frameworks may enable national identity data to be used for identity verification purposes, subject to appropriate privacy and data protection measures. This may extend to allowing collaborative or shared approaches to customer due diligence, including KYC utilities as discussed in 7.1.3. eKYC can improve the effectiveness and efficiency of customer due diligence measures (Lyman et al 2019) and provide correspondent banks with a higher level of comfort that ML/FT/PF risks are being managed appropriately.

"Safe harbour" provisions have also been raised in this context (UK Government 2015, Durner and Shetret 2015, Artingstall 2016). These refer to a range of measures that enable carve-outs or provide banks with legal protection where they engage certain customers or provide certain services deemed to be in the public interest, within the context of the FATF standards and risk-based approach.

The IMF and World Bank report on a draft methodology for a safe remittance corridor risk assessment discusses various examples of types of limited safe harbour provisions (IMF/World Bank

2021). It points to examples focused on customer identification and verification that relate to breaches that are administrative in nature, e.g. New Zealand's simplified due diligence arrangement regarding verifying the identity of customers through one of the means referred to in their Code of Practice where compliance provides a 'safe harbour' to all reporting entities (recorded in Box 9 of FATF 2017). The draft methodology report also mentions that "one country is considering introducing similar types of liability protections in lower risk scenarios for Remittance Service Providers (RSP), under certain conditions, including that all simplified measures required in the safe payment corridor (e.g., low amounts, identity verified, customers monitored against relevant lists) are fully implemented. This country is also reviewing extending such liability protections to banks with RSP clients, provided that the banks implement." The report furthermore mentions that the US AML Act of 2020 establishes a safe harbour from Banking Secrecy Act (BSA) liability and from adverse supervisory action for maintaining accounts on the basis of law enforcement "keep open" letters.

An example of a cross-border framework for a "safe harbour" provision is found in tax law where a domestic government can negotiate an Intergovernmental Agreement (IGA) with the US Treasury on compliance with the US Foreign Account Tax Compliance Act (FATCA) implementation. By signing an IGA, the domestic government reduces the risks and cost for local banks.

7.1.3 Better AML/CFT/CPF capacity

A wide range of actions have been recommended to assist countries improve their AML/CFT capacity. The main recommendations cover:

- Capacity building of national agencies and bodies
- National ML/FT/PF risk assessments
- Promotion of risk-based assessments/guidance to correspondent banks
- Capacity building of local banks and MTOs
- Improved CDD/KYC
- National KYC/eKYC utilities
- Improved oversight of de-risking decisions by banks and compliance measures by MTOs/NPOs
- Capacity building of NPOs
- Compliance codes of conduct for MTOs, NPOs

Many donor organisations have implemented programs aimed at supporting countries in capacity building, and the US Department of Treasury has recommended that such assistance be bolstered (Department of Treasury 2023). Assistance may also support compliance capacity-building by local banks, MTOs and NPOs, and could support adoption of compliance codes of conduct.

Maintaining a national ML/FT/PF risk assessment process and providing appropriate national risk information to regulated institutions to improve the quality of their risk management systems and enable correspondent banks to assess the ML/FT/PF country risk appropriately.

Meeting customer identity verification requirements can be a major challenge for countries with no or little means of official identification. This increases ML/TF/PF risk as well as the complications and costs of management of such risks by correspondent banks. In some cases, these challenges are being addressed by improving national identification systems. Improvements may also include digital identity frameworks that allow use of electronic means to assert and prove a person's official identity online (digital) and/or in-person environments at various assurance levels (FATF 2020). See Box 1.

Management of customer identity data by individual financial institutions can also be supported through collaboration in a range of models, often called **KYC utilities**. These collaborative CDD arrangements can be offered by commercial providers or industry bodies, sometimes in public-private partnerships, that manage customer identity data for use by multiple regulated institutions. By pooling resources, reducing duplicative efforts, and digitizing processes through KYC utilities, institutions can shorten the time required for identity checks and verification, reduce CDD compliance costs and potentially improve the quality and reliability of customer data (Lyman et al 2019). KYC utilities may access national identity data for purposes of customer verification and may also perform additional services such as scanning of customer names against sanctions lists. eKYC utilities mainly manage data electronically..

Box 1: Digital identity

The growth in digital financial transactions requires a better understanding of how individuals are being identified and verified in the world of digital financial services. A robust digital ID can allow individuals without a traditional identification to nonetheless have a robust form of identification to access financial services and improve financial inclusion. The FATF developed a Digital ID Guidance to better understand digital ID systems and how to identify when they can support the risk- based approach to CDD compliance framework. The World Bank issued, in 2020, a digital ID Toolkit which includes policy considerations of digital ID and financial inclusion, building on the 2013 FATF guidance on financial inclusion.

The G20 has made enhancing cross-border payments a priority during the Saudi Arabian Presidency. The FSB developed a roadmap to address the main challenges identified to enable cross-border payments – high costs, low speed, limited access and insufficient transparency – and the frictions that contribute to those challenges. One of the challenges identified by the CPMI to move forward the cross-border payments agenda refers to the need to foster improved IDdigital identity frameworks and shared customer due diligence. This need identified resulted in the following actions namely (1) Fostering better alignment and cross-border recognition of identity requirements, customer due diligence requirements and the digital identity assurance frameworks and technical standards, (2) Improving the coverage, access, and quality of the official ID databases for individuals and legal entities (3) Implementing shared or interoperable CDD infrastructure to allow financial institutions to access digital identity databases to meet their CDD obligations in a cost-effective way, domestically and on a cross-border basis.

To start with, rules related to AML/CFT apply differently depending on the type of institution providing the payment service, and at times there is no clarity on how to implement broad rules and cautious approaches to compliance often leads to exclusion of service to some groups of customers (e.g., migrants, rural population). Another challenge relates to the difficulties in meeting the regulatory requirements. (e.g., verification of ID attributes or biometric features), the ID infrastructure is either not available in the country, has poor coverage or not accessible by the Payment Service Provider (PSP). Potential conflicts between AML/CFT rules and data protection laws (e.g., data retention, data localization, consent) makes it also difficult for PSPs to develop suitable solutions to identify individuals for cross border transactions.

Some of the solutions identified to address these challenges include:

<u>KYC and CDD solutions</u>- Ensure that the legal and regulatory framework is supportive of the use of digital ID by financial service providers and ensure that the governance framework is adequate for the e-KYC solution. For individuals, seek solutions that offer authentication capabilities as they provide a higher level of assurance than the verification only capabilities and for legal entities exploring enhanced use of the LEI in cross-border payments. Foster harmonization of regulatory requirements for KYC and digital onboarding.

<u>AML/CFT</u>- Actions aim to improve consistency of bank and non-bank regulation and supervision; enhance information provided to end-users; and update the application of AML/CFT rules.

Fredesvinda Montes, Senior Financial Sector Specialist, The World Bank

7.2 Improving the enabling environment for CBR services

The 2023 review by the US Department of Treasury concluded that the primary factor driving financial institutions' de-risking decisions was profitability. Thus, recent recommendations have tended to focus on how to improve the commercial viability of CBR services.

7.2.1 Supporting digital financial services (DFS)

There are a number of recommendations aimed at supporting digital financial services. These cover:

- Adopting appropriate DFS regulation and strategies
- Considering the role of CBDCs as a potential solution in the longer term
- Trialling appropriate products – eg mobile money/online services

It is hoped that DFS may assist with lower costs, so a recent focus has been on improving the environment for their development, through, for example, the adoption of innovation-enabling regulation.

There is a high level of interest in the potential role of CBDCs in payments technologies in the longer term. There are also a range of new products available which use digital technology, and of course more pervasive and established technologies such as 'mobile money'. Digital identity systems support eKYC utilities by both increasing the reliability of the verification measures and improving their efficiency (Lyman 2019). However, digital identity systems need to be properly designed and supported by legislation. Two types of capacity assistance have been recommended for Pacific Island countries in this area (PIRI 2022):

- Assisting countries chose and adopt a trusted identity verification technology (one example being LEI
- Assisting supervisors to understand how to use digital identity systems for eKYC and how to guide institutions in their jurisdictions in the use of the systems.

7.2.2 Improving national infrastructure

Another set of recommendations are concerned with improving national infrastructure of various types. These concern:

- Support for (national) digital identity schemes
- Upgrading national payments systems framework and technology
- Joining the G20's safe remittance corridor risk assessment pilot
- Implementing ISO 20022 messages for SWIFT cross-border payments and cash management messages
- Improving access to financial services, e.g. by recognising a legal right to a basic bank account and a legal right for payment service providers to access the payment system
- Increasing the usage of bank accounts and payment services

The upgrading of national payment systems has been recommended as a means of reducing costs and supporting technical innovation (Alwazir et al 2017). Improved ID systems support more effective and efficient KYC measures and provide a greater source of comfort to correspondent banks that appropriate KYC is undertaken. Improved payments messaging provides respondent and correspondent banks with richer data to support improved ML/FT/PF risk management.

7.2.3 Regional solutions

Regional solutions aim to leverage transactions across more than one country in order to reduce the dis-economies of scale that face banks when servicing small countries such as the Pacific Islands.

The recommendations include:

- Harmonising regulations and practices to support intra-Pacific payments
- Regional eKYC recognition schemes
- Regional remittance schemes/intermediaries
- Government or regional clearing agents
- Subsidized correspondent bank compliance costs

7.3 Countering the effects of complete de-banking

Recommendations that are aimed at countering the effects of complete de-banking, rather than slowing or reversing de-banking, include contingency plans for de-banking.

The IMF advised that in the event of a complete loss of CBRs, consideration may be given to the use of public entities or centralized payments systems (IMF Mar 2017). Possible regional initiatives could include the setting up of regional payments arrangements. Some central banks located in countries affected by CBR withdrawal have also considered the feasibility of a temporary mechanism with foreign central banks in globally systemic countries to settle low risk transactions. That is however contingent on the willingness of foreign central banks to participate in such an arrangement. The possible use of central bank CBRs to process payments on behalf of commercial banks' clients could also be considered. A central bank could facilitate such transactions by maintaining a single account with the overseas banks while intermediating the CBRs. This would however expose central banks to financial and reputational risks. . Moreover, most of the regional central banks s may not have the capacity to undertake this role (IMF Mar 2023a).

The World Bank has recommended that national authorities develop a contingency plan to deal with a severe loss of CBRs. CBRs should be monitored continually and any withdrawal communications should be reported immediately to the central bank (The World Bank Group 2018). The US Treasury has also supported the modernisation of the US sanctions programs to facilitate humanitarian assistance (Department of Treasury 2023).

8 Stocktake of solution initiatives undertaken to-date

The solution initiatives that have been undertaken/considered by PIF countries can be usefully summarised under groupings above, namely: improving AML/CFT/PF risk management, improving the commercial viability of CBR services, and countering the effects of complete de-banking. A more detailed stocktake of initiatives being considered/undertaken in each country is provided in TP 4. Some initiatives suggested in the literature have not yet been considered by PIFcountries to date, and these are listed separately below.

8.1 Improving ML/FT/PF risk management

Collecting data on CBR closures

While some international agencies, such as the IMF and the FSB, have access to CBR data for countries, the information is not made available for public reporting or analysis. Individual countries can request information from SWIFT, which will be provided for a fee, but with confidentiality requirements heavily constraining the use that can be made of the data. For PIF member countries, the readily available information is restricted to the percentage change in CBRs, and overall transaction values and volumes, between selected years, published by CPMI and set out in Section 3 above. As part of the PIRI Action Plan, PIRI countries are investigating how to improve CBR-related data collection (PIRI 2022).

Improved collection of statistics

The IMF provides support to member countries in relation to the collection and publication of statistics. **Kiribati** authorities plan to implement the IMF's Enhanced General Data Dissemination System to help improve the availability of statistics (IMF Feb 2023). Making progress in disseminating more and better statistics in a timely manner, including macroeconomic and financial data, are also a priority for **Tonga** and **Nauru** (IMF Feb 2022, IMF Aug 2022).

Improved regional dialogues/information sharing

The Pacific Financial Intelligence Community (PFIC) is a regional forum, comprising 15 financial intelligence units (FIUs) located in the South Pacific region. Its purpose is to identify, develop and operationalise strategies to combat regional money laundering/terrorism financing matters[9]. The PFIC is led by AUSTRAC and the Cook Islands FIU. The PFIC encourages multilateral and bilateral collaboration across the region on issues of mutual priority through regular dialogue and engagement between members. It also provides a forum for Pacific wide engagement at international fora and with other external parties.

Enabling eKYC implementation to support remote onboarding

The enabling of eKYC implementation to support remote onboarding is being considered as a possibility by all IMF member countries in the Pacific Islands, with a resource within Pacific Financial Technical Assistance Centre (PFTAC) available to provide technical assistance[10].

Capacity building of national agencies and bodies

Many Pacific Island countries have taken advantage of technical assistance programs provided by the IMF, Asian Development Bank (ADB), APG, AUSTRAC, RBA and others, to improve the capacity of their national agencies and supervisory bodies. AUSTRAC has rolled out its TAIPAN system to a number of PI Forum countries, including **Fiji, Tonga, Solomon Islands, Nauru** and **Cook Islands,** and plans are underway to install the system in **Samoa, Kiribati, Tuvalu , Vanuatu** and **PNG** (as well as Palau and the Marshall Islands)[11]. TAIPAN will support Pacific FIUs in their ability to securely store

[9] Advice from DFAT, July 2023.

[10] Advice from IMF Department of Capital Markets, May 2023.

[11] Advice from DFAT, July 2023.

and analyse financial transaction data and to create financial intelligence for use by law enforcement, tax authorities and anti-corruption partners.

From early 2024, AUSTRAC will base a Liaison Officer in Suva, **Fiji**. The Pacific Liaison Officer will drive operational financial intelligence collaboration across the region and assist the Pacific Programs team in the delivery of AUSTRAC's Pacific capacity building programs covering financial intelligence and AML/CTF regulation (with support from other AUSTRAC SMEs).

The PFIC also aims to facilitate the capacity building of its members, including by providing assistance, advice and support to members seeking to redesign or enhance their IT systems in order to improve operational effectiveness and to create technology that promotes greater regional engagement across members[12].

The **Cook Islands** and **Fiji** are both assessed as having good supervisory capacity, with independent agencies employing strong supervisory frameworks (IMF Aug 2020, IMF Dec 2021).

Several countries (**Fiji**, **PNG**, **Samoa**, **Solomon Islands**, **Tonga** and **Vanuatu**, together with Timor-Leste, Australia and New Zealand) participated in the South Pacific Governors Meeting (SPGM) and are contributing to various project streams of the Pacific Remittances Project. One such examined the changes needed to guidance, legislation and policy in order to improve AML/CFT compliance culture, upskill remitters and stem de-risking (RBNZ Feb 2022).

No information specific to **French Polynesia**, **New Caledonia** and **Niue** is available, although France has taken steps to improve the implementation of AML/CFT measures in its overseas territories through awareness raising events for financial supervisors, secondment of advisors, and on-site visits of financial institutions (IMF Oct 2019).

Capacity building work is in progress in a number of jurisdictions. **Kiribati** is in the process of establishing an independent financial supervisor (IMF Feb 2023). The **Nauru** Government has put in place new AML/CFT legislation, with Technical Assistance being provided by the Asia Pacific Group (APG) and AUSTRAC to improve technical compliance (IMF Feb 2022). Likewise, the ADB has provided technical assistance to **PNG** on a range of AML/CFT initiatives, including preparing laws and regulations related to anti-money laundering (AML) and counter-financing of terrorism (CFT)[13]. The IMF has provided technical assistance to **Samoa** on a range of measures to strengthen risk management and provide training to Samoan authorities (IMF Mar 2023, Alwazir et al 2019). Samoan authorities are currently working to approve a regulatory framework for money lenders, credit unions and microfinance institutions.

Tonga has recently established the Financial Analysis and Supervision Coordinating Unit, which will strengthen AML/CFT supervision. Enhanced collaboration between Tonga's Financial Intelligence Unit, and regional AML/CFT supervisors and FIUs, is aimed at information sharing and enhancing Tonga's FIU analytical capacity (IMF Aug 2022).

Tuvalu authorities are planning to establish a domestic Financial Intelligence Unit, but have noted the difficulty of hiring suitably qualified personnel (IMF Aug 2021). In 2021/22, the APG provided

[12] Advice from DFAT, July 2023.

[13] Advice from ADB May 2023.

technical assistance for the development of a national AML/CFT policy and action plan[14]. Tuvalu intends collaborate with the PFTAC to build capacity in the financial supervision unit within Tuvalu's Public Enterprise Reporting and Monitoring Unit (IMF Aug 2021).

National risk assessments

Authorities in several jurisdictions are in the process of developing or updating a national risk assessment. **Nauru** is developing a national risk assessment and national strategy (IMF Feb 2022). **PNG**'s Financial Analysis and Supervision Unit has recently conducted sectoral risk assessments (IMF Sep 2022). **Samoa** was supported by the ADB in developing its national risk assessment and formulating a national AML/CFT strategy[15], and is currently conducting an updated AML/CFT risk assessment and elaborating a national AML/CFT strategy (IMF Mar 2023a). **Vanuatu** received assistance from the ADB to prepare its national risk assessment, with follow-on assistance provided on risk assessments for terrorist financing and offshore financial centres.[16]

Capacity building of local banks, MTOs and NPOs

Fiji's capacity of banks and MTOs is assessed as good by the IMF, given the strong licensing requirements for the banking sector and the fact that most banks in Fiji have good track records on AML/CFT compliance (IMF Dec 2021).

Other jurisdictions are working to strengthen the AML/CFT framework and provide training to supervised entities. Thus **PNG**'s Financial Analysis and Supervision Unit is working on changes to the AML/CFT legal framework and providing training to supervised entities (IMF Sep 2022), **Samoan** authorities have in the past been active in providing training to the staff of MTOs and other financial institutions (Alwazir et al 2019, Boulton and Winton 2018). **Tonga** authorities are augmenting their efforts to strengthen the AML/CFT framework, and are planning to conduct onsite visits to review banks compliance with AML/CFT regulations, including KYC requirements (IMF Aug 2022).

Promotion of risk-based assessments/ guidance to correspondent banks

In **PNG**, an IMF mission working with supervisory bodies on developing and finalizing prudential and risk management regulations included CBR issues.

Improved CDD/KYC

The ADB has made technical resources available to work with the Bank of **PNG**, Central Bank of **Samoa**, Central Bank of **Solomon Islands**, and Reserve Bank of **Vanuatu**, and government agencies, on key activities to improve KYC capacity.

With the assistance of the ADB, **PNG** developed arrangements for conducting risk-based KYC checks, reviewing AML/CFT requirements, and accepting eKYC in customer due diligence standards.

[14] Advice from APG June 2023.

[15] Advice from ADB May 2023.

[16] Advice from ADB May 2023.

National KYC utility

A number of jurisdictions participated in the regional KYC workstream of the SPGM Pacific Remittances Project, namely **Fiji, PNG**, **Samoa**, **Solomon Islands**, **Tonga** and **Vanuatu**[17]. Although the central bank participants did not wish to proceed with a regional eKYC utility, development of national eKYC facilities are continuing (RBNZ Feb 2022). The National Reserve Bank of Tonga is in the process of setting up national KYC system (IMF Aug 2022). With the support of the ADB, Vanuatu is piloting an eKYC utility. With assistance from the ADB, Samoa is developing a national electronic KYC utility (IMF Mar 2023a). Some other countries, such as **PNG** and the **Solomon Islands,** are doing some preliminary investigations into the possibility of developing a national eKYC facility.

Legal Entity Identifiers

The LEI, an initiative of the G20 is a unique global identifier that is available for legal entities participating in financial transactions. Use of the LEI assists authorities to identify institutions and helps institutions to undertake customer due diligence and reduce counterparty risk (GLEIF 2023).

8.2 Improving the enabling environment for CBR services

Adopting appropriate DFS regulation and strategies

A resource within PFTAC is available to provide technical assistance on adopting appropriate Digital Financial Services regulation and strategies and this is being considered by all IMF member countries

Considering the role of CBDCs

The IMF hosted a workshop on CBDCs, prompting IMF member countries to consider their position on the possible implementation of CBDCs.[18]

There is interest in CBDCs and blockchain technology in **Vanuatu**, and some legal reforms have been made recently to enable crypto assets to be held and digital trading in the offshore centre. However, the IMF noted that there are no immediate plans to adopt a CBDC in Vanuatu, and that the country lacks the technical capacity and infrastructure to test and adopt one (IMF Mar 2023).

Trialling appropriate products–- eg mobile money/online services

Fiji, **Samoa** and **Tonga** have been active in fostering mobile money services. Some 30% of remittances into Fiji are received into mobile wallets, and around half the adult populations of Samoa and Tonga have access to mobile money wallets (Capal 2022).

In 2017 the IFC and the Tonga Development Bank, in partnership with DFAT and MFAT, piloted the innovative ‘Ave Pa’anga Pau (APP) bank product with the objective of achieving a reduction in the remittance costs in the Tongan market. The product is low cost and AML/CFT compliant. In essence, a person registers online via a mobile phone with an APP affiliate in Australia or New Zealand. A registered customer can purchase a voucher in favour of a recipient in Tonga who holds a TDB account. Payment is made in Australian or New Zealand dollars and released into a TDB account of the recipient. It can be cashed out at a TDB branch or transferred to an account at another bank in

[17] Alongside Australia, New Zealand and Timor-Leste.

[18] Advice from IMF.

Tonga (UNDP 2019, IFC Nov 2020, ‘Ave P’anga Pau 2023, IMF Mar 2023). The pilots have been held to be successful and expansion to other Pacific Islands is being considered with **Vanuatu** considering introducing the voucher system (Becker 2023b).

Work on digitalisation is underway in other countries. In the **Solomon Islands**, The National Provident Fund has implemented a saving scheme that has advanced digital inclusion for informal workers, youSave LoMobile (IMF Jan 2022). In **Tuvalu**, a three-stage digitalisation plan is aimed at enabling online money transfers for customers, and was due to be completed at end 2022 (IMF Aug 2021). The National Bank of Tuvalu is also exploring options to upgrade its system, to provide online banking services and offer ATM, debit and credit card services (IMF Aug 2021). Vanuatu is still in the early stages of developing digital payment methods – although there was an increase in the use of mobile money services during the pandemic (IMF Mar 2023).

National digital identity scheme

Several countries are exploring national identity schemes. **PNG** adopted an enhanced digital identity solution using Near Field Communication technology to capture and store identity data (Davidovic et al 2019), and has undertaken a pilot on a biometric capture identification scheme designed for rural PNG and the informal sector.[19] In **Samoa** a national digital ID project is nearly finalised (IMF Mar 2023a).

The Pacific Digital Economy Programme conducted a study for **Vanuatu** which examined the current identity landscape, regulatory environment and customer readiness for a digital identity utility. The study concluded that Vanuatu would benefit from such a utility and made some recommendations on design (Pacific Digital Economy Programme 2021).

Upgrading national payments systems technology

The Pacific Payments Project, supported by the IFC and the World Bank, is aimed at upgrading payments systems to receive payments digitally. The automated transfer system allows real time gross settlement and permits retail payments to be made electronically. Participants in the project include **Fiji**, **PNG**, **Samoa**, **Solomon Islands**, **Tonga** and **Vanuatu** (World Bank Mar 2019).

In **Fiji** the process of upgrading the national payments system began with the passing of a new National Payments System Act in Feb 2021 (PIRI 2022). The National Reserve Bank of **Tonga** is upgrading the national payments system, under its Domestic Electronic Payment System (DEPS) project[20] (PIRI 2022, IMF Aug 2022). **Tuvalu** is considering using finTech expertise to develop a secure and easy-to-access digital national identity system. A feasibility study was undertaken to understand different platform options, including Bitcoin SV (IMF Aug 2021). The IMF reported that **Vanuatu**’s upgrade to the digital national payments system is expected to be completed by mid 2023 (IMF Mar 2023).

[19] Advice from ADB May 2023.

[20] In collaboration with KlickEx.

G20 safe corridor payment system

Samoa is exploring the possibility of joining the IMF/World Bank's safe remittance corridor risk assessment pilot, offered in the context of the G20/FSB Roadmap for Enhancing Cross-Border Payments.

Increasing the usage of bank accounts and payment service

PIRI members have adopted and implemented financial inclusion policies (PIRI 2022).

Regional eKYC recognition scheme

The Reserve Bank of Australia (RBA) and the Reserve Bank of New Zealand supported the Pacific Central Bank Governors' Forum as partners to investigate the establishment of a regional eKYC facility, aimed primarily at remittances (RBNZ 2022, Becker 2023). In June 2022 it was decided by the participating banks that they would rather focus on the development of domestic eKYC utilities for the time being.[21]

Regional remittance schemes/intermediaries

The IMF reported that **Vanuatu** is now using a new intermediary for some USD CBR business, *Choice Mauritius*. Choice Mauritius operates alongside the existing CBR for USD, Western Union (IMF Mar 2023).

Gov or regional clearing agents

The Pacific Payments Project created an automated clearing house for retail payments, which is to be available for use by e-wallet providers, as well as for retail payments by individuals, companies and the government (World Bank Mar 2019). As participants, **Fiji, PNG, Samoa, Solomon Islands, Tonga**, and **Vanuatu** all benefit from the scheme.

Samoa investigated using Crown Agents Bank for US, Australian and NZ CBR services, but is concerned that the service may be too expensive to be commercially viable.[22]

8.3 Recommended initiatives not yet actively explored by PIF members

Initiatives which have not yet been explored in PIF countries are discussed in TP 2: Literature Review of Recommendations addressing de-banking and its impact. They include:

a) Improving ML/FT/PF risk management

- Provision of more Pacific ML/FT/PF risk data to inform risk assessments by international banks
- Improving public-private risk information sharing
- Considering correspondent banking safe harbour provisions for lower risk jurisdictions
- Improved understanding of risk decisions by banks (Pending further info from IMF)
- Legal Entity Identifiers

[21] https://www.rba.gov.au/media-releases/2022/mr-22-18.html.

[22] Advice from Samoa FIU June 2023.

- Compliance codes of conduct for MTOs, NPOs

b) Improving the enabling environment for CBR services

- Planning for the implementation of ISO 20022 messages for SWIFT cross-border payments and cash management messages
- Recognising a legal right to a basic bank account and a legal right for payment service providers to access the payment system (e.g. as per EU Second Payment Services Directive). As these legal rights are recognised in France they may apply similarly in the French Territories of French Polynesia and New Caledonia).
- Subsidized correspondent bank compliance costs
- Harmonising regulations and practices to support intra-Pacific payments

c) Countering the effects of complete de-banking

- Contingency plans for complete de-banking

8.4 Stocktake summary

The following table summarises the initiatives being undertaken or explored by PI Forum members

Table 3: Stocktake of initiatives by country

Classification	Initiative	Lead Responsibility	Cook Isls	Fiji	French Polyn	Kiribati	Nauru	New Cal	Niue	PNG	Samoa	Sol Isls	Tonga	Tuvalu	Vanuatu
a) Improving ML/FT/PF risk management															
Better data	**Collecting data on CBR closures**	**PI Central banks/Global inst/Aus/NZ**		T						T	T	T	T		T
	Improved collection of statistics	**Government authorities/Aus/NZ**				T	T						I		
	Improved regional dialogues/information sharing	**PI regulators**											I		
Better regulation	**Enabling eKYC implementation to support remote onboarding**	**PI Regulators/ Australia/NZ**	P	P		P	P		P	P	P	P	P	P	P
Better AML/CFT/CPF capacity	**Capacity building of national agencies and bodies**	**Global institutions with supervisors/ Aus/NZ**	I	I	I	I	I		I	I	I	I	I	I	I
	National risk assessments	**PI governments/ Australia/NZ**	I	I		I	I		I	I	I	I	I	I	I
	Capacity building of local banks, MTOs and NPOs	**Supervisors/ Governments**	I	I		I	I		I	I	I	I	T	I	I
	Promotion of risk-based assessments/ guidance to correspondent banks	**Supervisors/ Global institutions/ Australia/NZ**								I					
	Improved CDD/KYC	**Banks/supervisory bodies**								I	I		T		
	National eKYC utility	**PI governments**		T						P	T	P	T		T

	Pacific Financial Intelligence Community (PFIC) member	PI governments (FIUs)	I	I		I	I		I	I	I	I	I	I	I
	G20 safe corridor remittance risk assessment pilot	PI governments/ regulators/IMF/ World Bank									P				
b) Improving the enabling environment for CBR services			**Cook Isls**	**Fiji**	**French Polyn**	**Kiribati**	**Nauru**	**New Caledon**	**Niue**	**PNG**	**Samoa**	**Sol Isls**	**Tonga**	**Tuvalu**	**Vanuatu**
Supporting digital financial services (DFS)	Adopting appropriate DFS regulation and strategies	PI regulators/ Australia/NZ	P	P		P	P		P	P	P	P	P	P	P
	Considering the role of CBDCs	PI governments/ Australia/NZ	P	P		P	P		P	P	P	P	P	P	P
	Trialling appropriate products–- eg mobile money/online services	PI regulators/ providers		I						T	I	T	I	T	
Improving national infrastructure	National digital identity scheme	PI governments								T	I			P	
	Upgrading national payments systems and technology	PI governments		I						I	I	I	I	T	T
	Increasing the usage of bank accounts and payment services	PI governments		I						I	I	I	I		I
Regional/ shared solutions	Regional eKYC recognition scheme	PI governments/ Australia/NZ		N						N	N	N	N		N
	Regional remittance schemes/intermediaries	PI governments/ Australia/NZ/ Remitters													T
	Gov or regional clearing agents	PI governments/ Australia/NZ		I						I	I	I	I		I

c) Countering the effects of complete de-banking			Cook Isls	Fiji	French Polyn	Kiribati	Nauru	New Caledon	Niue	PNG	Samoa	Sol Isls	Tonga	Tuvalu	Vanuatu
d) Ideas not yet being actively explored in the Pacific			**Cook Isls**	**Fiji**	**French Polyn**	**Kiribati**	**Nauru**	**New Caledon**	**Niue**	**PNG**	**Samoa**	**Sol Isls**	**Tonga**	**Tuvalu**	**Vanuatu**
a) Improving ML/FT/PF risk management															
Better data	Provision of more Pacific ML/FT/PF risk data to inform risk assessments by int'nal banks	APG/Global institutions/ AUSTRAC/NZFIU													
	Improving public-private risk information sharing	Private sector/PI FIUs/law enforcement/ AUSTRAC/NZFIU													
Better regulation	Considering correspondent banking safe harbour provisions for lower risk jurisdictions	PI regulators/ Australia/ NZ													
Better AML/CFT/CPF capacity	Improved understanding of risk decisions by banks	PI supervisory bodies/Australia/ NZ													
	Legal Entity Identifiers	Banks													
	Compliance codes of conduct for MTOs, NPOs	Industry bodies													
b) Improving the enabling environment for CBR services															
Improving national infrastructure	Plan for implementing ISO 20022 messages for SWIFT cross-border payments and cash management messages	Banks													

	Recognising a legal right to a basic bank account and a legal right for payment service providers to access the payment system (e.g. as per EU PSD2)	**PI governments/ Australia/NZ**			*			*							
Subsidies	**Subsidized correspondent bank compliance costs**	**PI governments /Australia/NZ**													
Regional /shared solutions	**Harmonising regulations and practices to support intra-Pacific payments**	**PI governments/ Australia/NZ**													
c) Countering the effects of complete de-banking															
	Contingency plans for extreme de-banking	**PI governments/ Banks/Australia/NZ**													

Key:

	a) Improving ML/FT/PF risk management			*b) Improving the commercial viability of CBR services*			*c) Countering the effects of de-banking*
I	***Has been or being implemented***		***I***	***Has been or being implemented***		***I***	***Has been or being implemented***
G	***Assessed as good***		***G***	***Assessed as good***		***G***	***Assessed as good***
T	***Being trialled or piloted, or preparations underway***		***T***	***Being trialled or piloted, or preparations underway***		***T***	***Being trialled or piloted, or preparations underway***
P	***Being investigated as a possibility***		***P***	***Being investigated as a possibility***		***P***	***Being investigated as a possibility***
N	***Investigated but not being pursued***		***N***	***Investigated but not being pursued***		***N***	***Investigated but not being pursued***

Notes to table:

* In place in France - https://www.elibrary.imf.org/view/journals/002/2019/326/article-A001-en.xml
However there is no information on whether it also applies in its Pacific territories.

9 Recommendations

The analysis for this paper shows that CBRs in the Pacific continue to decline for the region as a whole, although experiences differed for individual Pacific Island states. That decline is taking place against the general global decline in CBRs over the past decade.

The stocktake analysis of the de-risking initiatives in the Pacific reflect the varied range of interventions and actions. While such interventions resulted in strengthened integrity frameworks and regulations, improved data collection and management, and better compliance and enforcement capacity they have not had a clear impact on reversing the de-risking tide.

Given the wide range of interventions and improvements that are underway or are being explored in the Pacific, these Recommendations focus on measures that the PIF can undertake to support national action and strengthen the resilience of the region as a whole against CBR de-banking. The recommendations therefore focus on regional actions that may support the wide range of domestic actions outlined in Section 8 above.

The recommendations are broad and aimed at supporting domestic mitigation strategies. The recommendations and strategies would work best in combination. No single recommendation would provide a solution on its own. Sustained action in every country and at a regional level is required to ensure that the Pacific is an enabling environment for CBRs.

Over the past years much planning work has been done to stem the loss of CBRs. Reforms that have been planned, however, need to be implemented and consistent action is required on action plans. Regional solutions may be helpful but they can only work if the relevant countries are aligned and take steps to strengthen their own frameworks first.

The following recommendation are made:

1. The Forum should continue to support action by Forum members to meet global financial standards and to collaborate with counterparts to improve tax transparency.
2. The Forum should support broad Pacific Island piloting of the draft remittance corridor risk assessment methodology developed by the World Bank and the IMF. The Secretariat should analyse the outcomes of these assessments to inform appropriate risk assessment methodologies that would provide improved risk-related information to respondent and correspondent banks, AML/CFT/CPF-regulated businesses and their regulators in relation to the Pacific.
3. The Secretariat should encourage and guide efforts by central banks and Ministries of Finance of members to collect relevant CBR data and support the reporting of annual trends to Forum ministers. This may include negotiating better access to SWIFT data for the region.
4. The Secretariat should assess the strengths and gaps in current financial integrity information-sharing frameworks and practices among members in relation to key Pacific payment corridors and advise on appropriate improvements and frameworks to support alignment, where required.
5. The Secretariat should provide a platform for Pacific engagement with appropriate parties to key Pacific CBR corridors to explore the feasibility and design of cross-border public-private partnerships and regulatory safe harbour CBR frameworks for Pacific jurisdictions.

6. The Secretariat should undertake a diagnostic assessment of the enabling environment for the banking sector to identify opportunities for strengthening. The first step would be to develop an appropriate methodology for such a diagnostic.
7. The Secretariat should advise on an appropriate regional strategy in relation to the innovations and changes that may flow from the G20 'Roadmap for Enhancing Cross-border Payments' project. This should be a regional initiative to overcome capacity and resource constraints.
8. The Secretariat should develop a CBR resilience framework, take stock annually of de-risking actions and report on progress towards CBR resilience.

1. Continue improving national and institutional AML/CFT/CPF systems

FATF-related greylisting and EU tax transparency blacklisting trigger enhanced due diligence by correspondent banks and related negative impact for CBRs, especially for EU and UK correspondent banks (Collin 2023; De Koker et al 2023). Continued action to ensure that Pacific jurisdictions meet FATF standards and to take appropriate steps to support collaboration with counterparts on tax transparency will help to prevent ML/TF/PF and tax risks considerations from unduly impacting CBRs negatively.

> **Recommendation: The Forum should continue to support action by PI jurisdictions to meet required standards and to collaborate with counterparts to improve tax transparency**

2. Improve the understanding of AML/CFT/CPF risk to Pacific CBRs

The FATF standards require countries to have money laundering and terrorist financing national risk assessments and, since 2020, also proliferation financing risk assessments. National risk assessments provide important information about the relevant threats and vulnerabilities of the respective countries. National risk assessments may however not reflect accurate risk levels as they are often performed with limited data, may not employ best practice methodologies, and may not be published in full.

There is a need to revisit the risk assessment approaches in relation to the Pacific and to consider to what extent available information is reliable and informs appropriate regional and country ML/FT/PF risk assessments by banks. It is furthermore important to ensure that appropriate information is shared with respondent and correspondent bank, AML/CFT/CPF-regulated businesses and their regulators. Participation by Pacific jurisdictions in a pilot of the World Bank and IMF's Remittance corridor risk AML/CFT assessment methodology would be a constructive step in that regard, especially where that assessment exercise can be expanded to CPF risk too.

More data and up-to-date information on ML/FT/PF risks of Pacific jurisdictions are required given that APG mutual evaluation reports and even follow-up reports may be dated and not provide current information about improvements in effectiveness of AML/CFT/CPF regimes.

> **Recommendation: The Forum should support broad Pacific Island piloting of the draft remittance corridor risk assessment methodology developed by the World Bank and the IMF. The Secretariat should analyse the outcomes of these**

assessments to inform appropriate risk assessment methodologies that would provide improved risk-related information to respondent and correspondent banks, AML/CFT/CPF-regulated businesses and their regulators in relation to the Pacific.

3. Improve data collection on CBRs

It is important to improve data collection on CBRs to track development and assess the impact of interventions. Data collection could be done by central banks or governments of members, with the PI Forum Secretariat playing a co-ordinating role – for example collating de-identified data and potentially collaborating with PIRI members.

Relevant data would ideally include, per country, annual statistics held by SWIFT on:

- The number of unique counterparts of domestic institutions
- The number of unique counterparty countries
- The currencies being traded with
- Total number of banks providing CBRs
- The volume of transactions processed through SWIFT
- The value of transactions processed through SWIFT

This data, combined with remittance volumes and cost data collected by the World Bank and Saver Global, can enable the Secretariat to track and report on changes in CBRs in relation to Forum members. Wider information on costs of banking services would also be helpful, including for the countries for which World Bank and Saver Global data is not available.

While SWIFT holds relevant data this is not generally available. Access to the data and conditions for sharing data will need to be negotiated.

Recommendation: The Secretariat should encourage and guide efforts by central banks and Ministries of Finance of members to collect relevant CBR data and support the reporting of annual trends to Forum ministers. This may include negotiating better access to SWIFT data for the region.

4. Strengthen regional frameworks

Financial integrity in the Pacific would be strengthened by improved cross-border payment systems, information-sharing and institutional and agency collaboration, including supervisory oversight and collaboration among the jurisdictions in relation to important Pacific payment corridors. New technologies provide additional means to share information securely and to collaborate while observing appropriate data protection and privacy principles. As each jurisdiction works on improving their own statutory frameworks, new barriers may unintentionally be created. A lack of alignment in customer due diligence requirements may for example complicate compliance in relation to cross-border transactions and inadvertently increase the costs of services. It is for example important to design a framework to ensure that formal eKYC verification undertaken in one country will be recognised in other countries when a cross-border remittance transfer occurs, or another intra-Pacific payment is made.

Recommendation: The Secretariat should assess the strengths and gaps in current financial integrity information-sharing frameworks and practices among members in relation to key Pacific payment corridors and advise on appropriate improvements and frameworks to support alignment, where required.

5. Explore the need and potential for a public-private partnership and regulatory safe harbour CBR framework for Pacific jurisdictions

A range of studies of de-risking drivers reflect correspondent bank concerns about regulatory risk relating to CBRs as well as the costs and of providing the services. For some years calls have been made for the investigation of a public-private partnership that would allow the management of business relationships that serve the public good. Should such needs be identified as relevant to the resumption or establishment of specific CBRs in the Pacific, such a public-private partnership frameworks may include one or more elements such as the following:

- Government information-sharing to facilitate and support appropriate management of ML/FT/PF risks in relation to such services;
- Subsidies for reasonable costs incurred in the provision of such services, should that be required;
- Cross-border regulatory safe harbour provisions that reasonably limit the liability of banks and their employees in relation to AML/CFT/CPF compliance-related risk in business relationships and services that regulators deem to be in the public interest, within the framework of FATF standards and the risk-based approach; and
- Supervisory support for mitigation of reputational risk where, despite reasonable efforts of all parties involved, ML/TF/PF financing abuse occurs, including careful supervisory consideration of the impact of publicising fines that may be levied in the context of services delivered in a safe harbour framework.

Conditions for such frameworks will ideally need to be determined and negotiated by broad group of stakeholders including relevant international and domestic banks; domestic and foreign governments including their FIUs, regulators and supervisors; donors; the APG; and representatives of industry and civil society. Their discussions will benefit from appropriate risk assessments as well as service cost assessments. Opportunities for foreign regulator support for safe harbour arrangements will be dependent on the quality of domestic AML/CFT/CPF frameworks and hence the earlier recommendations, in particular Recommendation 1 and 2, are relevant.

Recommendation: The Secretariat should provide a platform for Pacific engagement with appropriate parties to key Pacific CBR corridors to explore the feasibility and design of cross-border public-private partnerships and regulatory safe harbour CBR frameworks for Pacific jurisdictions.

6. Support the performance of a diagnostic assessment of the enabling environment for the banking sector and identify opportunities for enhancement

The relatively small scale of the Pacific Island economies and risk reward considerations informed the decisions of several international banks decide to leave the region. It is important to support an enabling framework for the banking sector that responds to the risks and opportunities in each jurisdiction. An important starting point is to perform a diagnostic assessment of the enabling environment for the banking sector to identify opportunities for enhancement.

Such an assessment of the enabling environment would look holistically into areas such as banking law, regulation and supervision, taxes, government policy, credit and collateral information and registration, legal rights of borrowers and lenders and their enforcement, local capacity and skills. A methodology to assess the enabling environment for banks would need to be developed and ideally support should be provided to each jurisdiction in relation to the diagnostic.

> **Recommendation: The Secretariat should undertake a diagnostic assessment of the enabling environment for the banking sector to identify opportunities for strengthening. The first step would be to develop an appropriate methodology for such a diagnostic.**

7. Formulate a regional strategy in relation to the innovations and changes emerging from the G20 Roadmap for Enhancing Cross-border Payments

The Enhancing Cross-border Payments project is continuing at pace and the presents opportunities for the Pacific, also in relation to de-risking. It is opportune to consider the potential implications of the emerging solutions and appropriate strategies that the Pacific region should consider.

> **Recommendation: The Secretariat should advise on an appropriate regional strategy in relation to the innovations and changes that may flow from the G20 'Roadmap for Enhancing Cross-border Payments' project. This should be a regional initiative to overcome capacity and resource constraints.**

8. Develop a CBR resilience framework and annually report progress towards CBR de-banking resilience

As reflected in the report a range of action are being undertaken in different member countries. The report also advises each country to consider the number and quality of CBRs and the strategy it requires, to be resilient against de-risking (4.1.1 above).

Much of the attention to date was on preventing further losses of CBRs. It would be important to establish the ideal number and quality of CBRs for each country to be sufficiently resilient against de-risking, and to determine strategies to ensure that this threshold is reached and sustained. This would require consultation with the banks that are providing CBRs to those countries as well as their supervisors. A CBR resilience target will support the monitoring of progress in relation to CBR resilience and help to identify a developing CBR de-banking crisis.

It is important to understand the costing of their current CBR services and concerns that may impact on the continuation of those services, and agree on reasonable notice periods and conditions should they wish to withdraw. Where further CBRs need to be established, similar engagement with the banks most likely to provide additional CBRs in the future will be required to understand their requirements and conditions for the establishment of such relationships. Communication with respondent and correspondent banks and their regulators is important to build CBR resilience.

A resilience strategy should also include contingency plans in case of complete de-banking, where that is a real risk. Potential measures to ensure that commercial payments, remittances and humanitarian aid can continue to flow are complex (IMF Mar 2023a) and contingency plans are best prepared well in advance of such an event. See 7.3 above.

The Secretariat should, in collaboration with members and donor agencies, take stock of de-risking initiatives annually and track progress in relation to the de-banking resilience objectives of each member. Ideally a framework or “dashboard” should be developed which classifies the status of de-banking in individual countries according to agreed criteria, including in relation to a country-specific CBR de-banking resilience criteria. Such a framework could be developed by an international agency, such as the World Bank or the IMF. This information, combined with de-risking data collected by it, should inform an annual report on progress with such actions and on de-risking developments in the region to enable the Forum to determine whether CBR de-risking resilience in the region is improving.

Recommendation: The Secretariat should develop a CBR resilience framework, take stock annually of de-risking actions and report on progress towards CBR resilience

10 List of background Technical Papers

This paper is supported by the following technical papers:

1. De-risking and de-banking in the context of AML/CFT regulations
2. Literature Review: Stocktake of initiatives being undertaken by PI Forum countries
3. Literature Review: Extent and impact of CBR decline on PIF countries
4. Evidence from previous studies on progress made in each country
5. Analysis of questionnaires
6. Empirical analysis
7. List of references
8. Acronyms