

Prospects for blockchain-based settlement frameworks as a resolution to the threat of de-risking to Caribbean financial systems

Robert Crane Williams



UNITED NATIONS

ECLAC

INDUSTRY NEWS

Bank of America cancels Belize correspondent banking operation

Monday, 27 April, 2015

Bank of America has cancelled its correspondent banking operation with the domestic and international branches of Belize Bank.



Tribune 242

Correspondent De-Risk Threatening 25% Of Bahamas Institutions

By Natario McKenzie

The Central Bank's chief inspector warned yesterday that 25 per cent of its licensees will find it "difficult" to maintain existing correspondent banking relationships, even though they are exposed to "wholesale vulnerability" yet.

Abhilash Bhachech, the Central Bank's inspector of banks and trust companies, said licensees may encounter trouble in maintaining existing links to the international market themselves and their clients.

Mr Bhachech said he was referring, in particular, to 'standalone' Bahamian institutions where the security or comfort of backing from a global parent

As of Tuesday, November 15, 2016



Guyana still at risk of correspondent banking de-risking – IMF

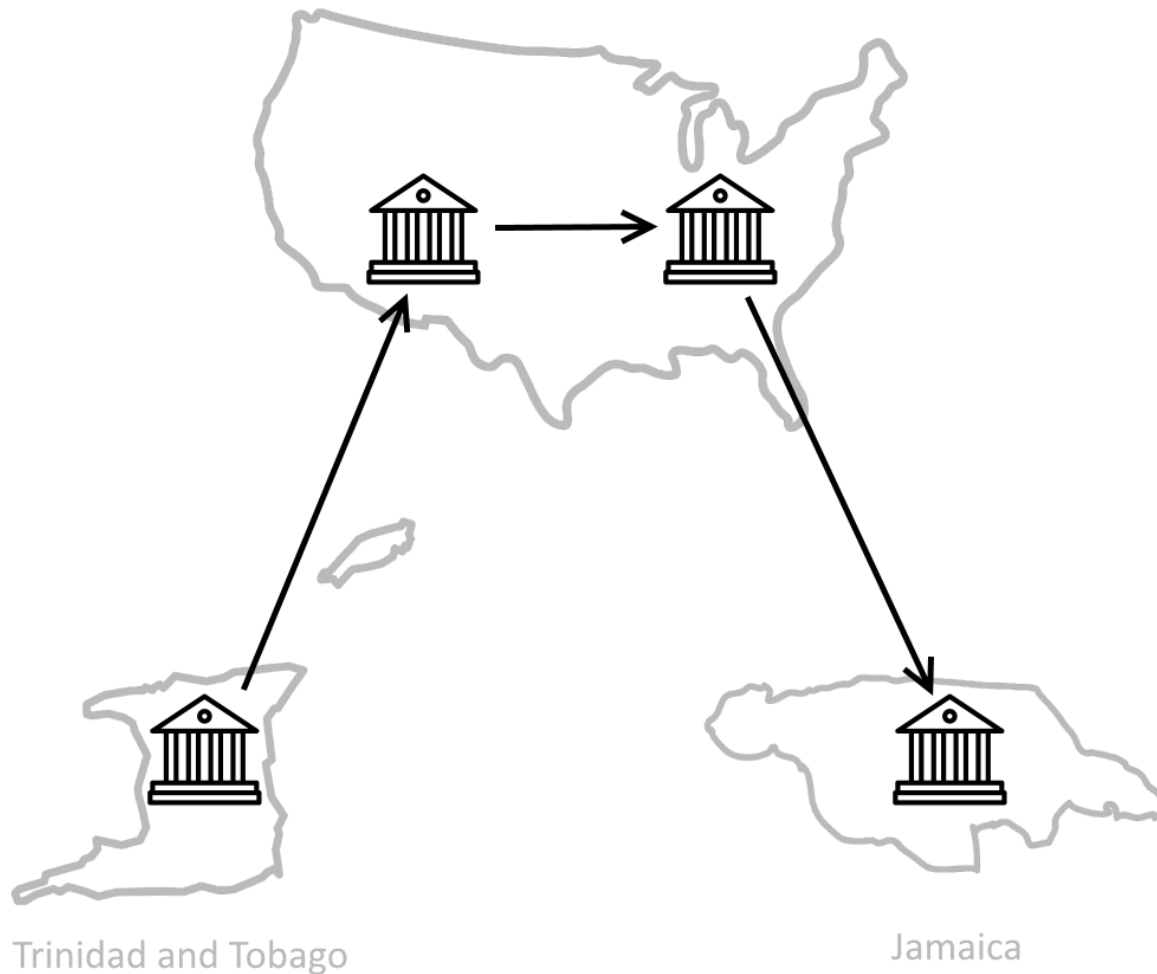
March 27, 2017

152

...urges continued recommendations adherence

The effects on Guyana if Correspondent Banking Relationships (CBRs) continue to be affected are a major concern for the International Monetary Fund (IMF). This is according to an IMF team, which recently conducted a mission in Guyana and released its preliminary report.

Correspondent banking



The Caribbean Association of Banks has indicated that almost **60% of member institutions** that it has interviewed report a loss of one or more correspondent banking relationships, and that, even in some cases where relationships have been maintained, **key services, such as check clearance and wire transfers, have been discontinued.**

NEWS

HSBC to pay \$1.9bn in US money laundering penalties

11 December 2012 | Business

Share

HSBC has confirmed it is to pay US authorities \$1.9bn (£1.2bn) in a settlement over money laundering, the largest paid in such a case.

A US **Senate investigation** said the UK-based bank had been a conduit for "drug kingpins and rogue nations".

Money laundering is the process of disguising the proceeds of crime so that the money cannot be linked to the wrongdoing.



HSBC has admitted its money laundering controls have been too lax

Reasons for de-risking

- Concerns about **compliance**
 - Anti-money laundering/countering terrorist financing (**AML/CFT**)
 - International sanctions (especially Cuba)
- Cost of **customer due diligence (CDD)** and concern over correspondent bank's CDD practices
 - Know your customer (KYC)
 - Know your customer's customer
- Reduction in overall risk appetite
 - Structurally important financial institutions
 - Elevated capital reserve requirements
- **Lack of profitability** of correspondent banking services

Can blockchain tech solve de-risking?

Not Yet

What's the hold up?

- Technology is **not yet** mature
- Privacy concerns are **not yet** resolved
- Regulators are **not yet** engaged
- Governance models are **not yet** in place
- Monitoring capacity is **not yet** established
- Integration with existing institutions and information systems has **not yet** occurred

Regardless of whether value is transferred through a blockchain or through the traditional wire service, **correspondent banks still have regulatory obligations** with regard to AML/CFT, CDD, tax transparency, and economic sanction regimes.

Migration of the international money transfer infrastructure to blockchain technology would not make these obligations – **and their associated costs** – disappear.

But blockchains do present some opportunities...

Blockchains can be used to...

- Make monitoring easier

A blockchain-based settlement network can offer tools to improve surveillance of transactions, which would **enable better detection of illicit financial transfers** and thereby decrease risk and associated compliance costs.

- Cut out the middleman

A blockchain-based network may eventually offer Caribbean banks the opportunity to **bypass correspondent banks** altogether.

Blockchain-based options for bank clearance and settlement

1) The Open Model

Use Bitcoin or another **commodity-like digital currency** – either directly, or by building on top of their public blockchain

2) The Permissioned Model

Use blockchains **operated by a restricted consortium of banks** and other institutions

3) The Centralized Model

Central Bank-issued Digital Currencies (**CBDCs**)

Open blockchains

- Bitcoin, Ethereum, DASH..... **this is where innovation comes from.**
- But its also the **Wild West.**
- Pseudonymous ≠ Private

Permissioned blockchains

- Restricted to a limited set of participating institutions
 - So how is **governance** to be managed?
- Under **intense development** by the banking industry and large ICT players like Microsoft and IBM
- Not likely to be headquartered in the Caribbean
 - So **not much benefit to monetary sovereignty**
- Data **privacy is still a problem**

Central Bank-issued Digital Currency

- Direct issuance of **digital currency by central banks**, either in parallel with or as a replacement for existing paper currencies
- Every user of a currency would have an account on a blockchain managed by the central bank and would **use that account as the primary means for conducting settlements**

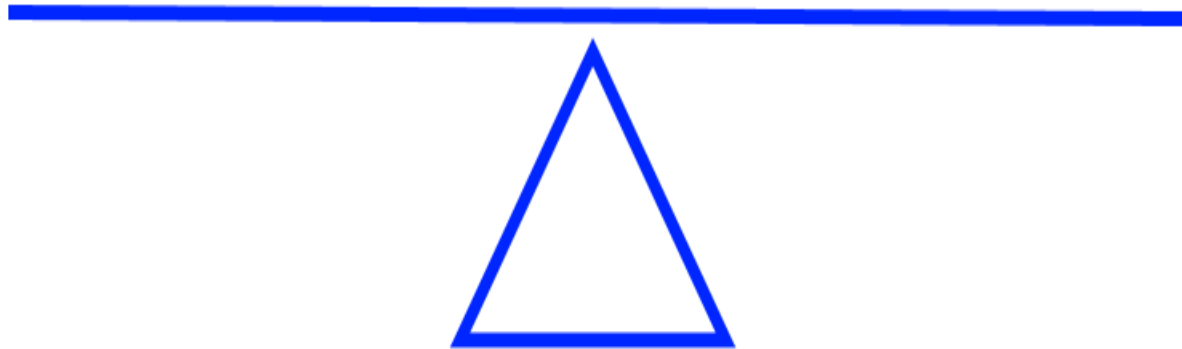
Central Bank-issued Digital Currency

- Radical economic change
- Highly **auditable** – financial crimes can be more easily detected
- Privacy issue is resolved
 - Except for **Big Brother** watching you

Balancing privacy and auditability

Privacy

Auditability



Conclusion

- Solutions utilizing Blockchain are **not likely to be ready in time** to resolve the de-risking problem
- But it would be nice to have some **arrows in the quiver to deal with the next shock** that comes down from the international financial system
- So, lets **let innovators innovate**

<http://vrb.al/eclac-derisking-fintech>

Robert Crane Williams (Bobby)
Robert.Williams@eclac.org
spikewilliams@gmail.com