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STRENGTHENING FINANCIAL TRANSPARENCY: REBUILDING TRUST IN CORRESPONDENT BANKING IN THE CARIBBEAN

(RG-T2924)

DONORS MEMORANDUM

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PROJECT SUMMARY

STRENGTHENING FINANCIAL TRANSPARENCY: REBUILDING TRUST IN CORRESPONDENT BANKING IN THE CARIBBEAN"

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In recent years, there has been a growing trend towards reduction in Correspondent Banking relationships (CBRs) in many countries, which either pose, or are perceived to be a money laundering risk. This phenomenon known as "de-risking" has been described and analyzed in a series of recent reports and surveys, from the Bank for International Settlements (BIS), the World Bank, the international Monetary Fund (IMF), as well as think tanks and independent researchers.

One of the main triggers for "de-risking" is the fact that there are tougher AML/CFT regulations in place, globally through the Financial Action Task Force (FATF), which all countries must adhere to. The effect on international banks are rising operating costs particularly in small markets and in terms of AML/CFT, uncertainty for example about how far customer due diligence should go in order to ensure regulatory compliance (i.e. the extent to which banks need to know their customers' customers – the so-called KYCC). As a result, in order to avoid penalties and related reputational damage, international banks are now increasingly sensitive to the risks associated with correspondent banking. They have therefore withdrawn services from local respondent banks that (i) do not generate sufficient volume to overcome compliance costs; (ii) are located in jurisdictions perceived as too risky; (iii) provide payment services to customers about whom the necessary information for an adequate risk assessment is not available or not collected; or (iv) offer products or services or have customers that pose a higher risk for anti-money laundering/combating the financing of terrorism (AML/CFT) and are therefore more difficult to manage in terms of this risk. Other causes include shifting business models on the part of international banks, requiring more efficiency and reduced operating costs and therefore the tendency to withdraw from small markets were costs are deemed to be too high relative to income from correspondent banking services.

The de-risking phenomenon is particularly acute in the Caribbean. As of May 2016, "de-risking" had resulted in at least 16 banks in the Caribbean losing their CBRs, with additional withdrawals expected by the end of the year. While a number of these banks have secured new CBRs, these new relationships involve higher costs for CB transactions. De-risking has affected a diverse set of countries in the region including the Bahamas, Belize, Jamaica, and the OECS. Some Caribbean countries present an increased reputational risk due to the presence of a significant offshore banking sector. Credit Unions have been affected as well, as Know Your Customer (KYC) and source of funds collected "over the counter" have come under increasing scrutiny, particularly those credit unions providing remittances services. While some of the causes of de-risking, such as the decision to withdraw from a particular market, based on market size, are to a large extent outside the control of the countries affected, important steps can be taken to alter the perception of risk.

The overall objective of this project is to increase the level economic activity by micro, small and medium-sized enterprises and individuals by increasing financial transparency in Caribbean countries. The specific objective is to help prevent and mitigate the risk of loss of Correspondent Banking Relations in the Caribbean region To achieve these objectives, the project will work in three key areas: a) strengthening the implementation of international financial integrity standards by governments in the region; b) increasing the technical capacity of financial institutions in the Caribbean to conduct customer due diligence and adopt AML/CFT best practices; and c) improve public-private sector coordination to more effectively address de-

risking and develop a mechanism for ongoing dialogue between this constituency and external regulators and international banks.

The MIF will contribute US$465,000 to this project, with US$200,000 in co-financing from the IDB, US$ 436,158 in counterpart contributions and an estimated US$250,000 from the Caribbean Development Bank, which has expressed interest in partnering on this project. The IDB and the Association of Supervisors of Banks in the Americas (ASBA) will be co-executors of the project, coordinating the execution of the components.

Annexes

Appendices

Information Available in the Technical Documents Section of MIF Project Information System

ACRONYMS AND ABBREVIATIONS

AML/CFT	Anti-Money Laundering/Combatting the Financing of Terrorism
ASBA	Association of Supervisors of Banks in the Americas
BIS	Bank for International Settlements
CAB	Caribbean Association of Banks
CARICOM	Caribbean Community
CB	Correspondent Banking
CBR	Correspondent Banking Relationship
CCCU	Caribbean Confederation of Credit Unions
CEMLA	Center for Latin American Monetary Studies
CDB	Caribbean Development Bank
CDD	Customer Due Diligence
CFATF	Caribbean Financial Action Task Force
CPMI	Committee on Payments and Market Infrastructures
DNA	Diagnostic of Executing Agency Needs
FATF	Financial Action Task Force
FI	Financial Institution
FSR	Final Status Report
FSRBs	FATF-style regional bodies
JNBS	Jamaica Nationals Building Society
IDB	Inter-American Development Bank
IIC	Inter-American Investment Corporation
KYC	Know Your Customer
KYCC	Know Your Customer's Customer
MIF	Multilateral Investment Fund
MSMEs	Micro, Small and Medium-Sized Businesses
OECS	Organization of Eastern Caribbean States
PSR	Project Supervision Report

PROJECT INFORMATION
TITLE
(RG-T2429)

Country and Geographic Location:	English-speaking Caribbean Countries that are members of CARICOM[1], particularly Bahamas, Belize, Jamaica, and the OECS[2]		
Executing Agency:	Association of Supervisors of Banks of the Americas (ASBA)		
Focus Area:	Knowledge Economy		
Coordination with Other Donors/Bank Operations:	Bank Operations: RG-T2224 and RG-T2670; Additional counterpart donor: Caribbean Development Bank		
Project Clients:	4 countries as well as the OECS and their respective financial system supervisory authorities; 30 financial institutions and their employees; banking regulators from the OECS and 9 CARICOM countries that are members of ASBA.[3]		
Financing:	Technical Cooperation:	US$ 465,000	
	TOTAL MIF FUNDING:	US$ 465,000	
	Counterpart - ASBA	US$ 186,158	
	Counterpart – Financial Institutions	US$ 250,000	
	Co-financing (IDB):	US$ 200,000	
	Co-financing (CDB):	US$ 250,000*	
	TOTAL PROJECT BUDGET:	US$1,351,158	
Execution and Disbursement Period:	36 months of execution and 42 months of disbursement.		
Special Contractual Conditions:	Special conditions precedent to first disbursement will be: (i) Hiring of a Program Manager; (ii) Signed letters of commitment from the CAB, the CCCU and CFTAF agreeing to be a project partner through collaboration, by contributing resources to the project either in-kind or in cash, and mobilizing their membership to participate in the project; (iii) approval of the CDB contribution.		
Environmental and Social Impact Review:	This operation was screened and classified as required by the IDB's safeguard policy (OP-703) and reviewed by ESR on November 2 2016. Given the expected limited social and environmental impacts and risks of the project, it was classified under category C,		

*Amount proposed, but not yet approved

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[1] The Caribbean Community (CARICOM) is The Caribbean Community (CARICOM) is a grouping of twenty countries: fifteen Member States (all the countries in English-speaking Caribbean and Haiti), as well as five Associate Members (Anguilla, Bermuda, the British Virgin Islands, the Cayman Islands and Turks and Caicos Islands). Its purpose is to promote regional economic integration and cooperation among its members.

[2] The Organization of Eastern Caribbean Countries (OECS) includes: St. Lucia, Antigua and Barbuda , St. Kitts and Nevis, Dominica, Grenada, St. Vincent and the Grenadines, and Montserrat.

[3] The Bahamas, Belize, Guyana, Haiti, Jamaica, the OECS countries, Suriname, and Trinidad & Tobago.

1. THE PROBLEM

A. Problem Description

1.1. Correspondent banking relations (CBRs) facilitate access to financial services across jurisdictions, including cross border payments connected to remittances, trade financing and other economic activities. Well-functioning CBRs also facilitate financial inclusion. In recent years, there has been a growing trend towards reduction in CBRs in many countries, creating a problem known as "de-risking". This phenomenon has been described and analyzed in a series of recent reports and surveys, from the Bank for International Settlements (BIS), the World Bank, the international Monetary Fund (IMF), as well as think tanks and independent researchers.[4]

1.2. According to the Committee on Payments and Market Infrastructures (CPMI) of the Bank for International Settlements (BIS), de-risking refers to the withdrawal of correspondent banking relations (CBRs) by international banks from small countries and markets, which pose (or are perceived to pose) a high money laundering risk.[5] One of the main reasons behind "de-risking" is the fact that there are tougher AML/CFT regulations in place, globally through the Financial Action Task Force (FATF)[6], which all countries must adhere to. The effect on international banks are rising operating costs particularly in small markets and in terms of AML/CFT, uncertainty for example about how far customer due diligence should go in order to ensure regulatory compliance (i.e. the extent to which banks need to know their customers' customers – the so-called KYCC). As a result, in order to avoid penalties and related reputational damage, international banks are now increasingly sensitive to the risks associated with correspondent banking. They have therefore withdrawn services from local respondent banks that (i) do not generate sufficient volume to overcome compliance costs; (ii) are located in jurisdictions perceived as too risky; (iii) provide payment services to customers about whom the necessary information for an adequate risk assessment is not available, or not collected; or (iv) offer products or services or have customers that pose a higher risk for anti-money laundering/combating the financing of terrorism (AML/"CFT) and are therefore more difficult to manage in terms of this risk. International banks therefore withdraw from countries that present excessive money laundering risks,

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[4] The main reference documents are: Center for Global Development, Unintended Consequences of Anti-Money Laundering Policies for Poor Countries", November 2015. Bank for International Settlements, "Consultative Report, Correspondent Banking", October 2015. International Monetary Fund, "The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action", June 2016. World Bank, "Withdrawal from Correspondent banking, Where, Why and What to do About it", December 2015. Bruce Zagaris, "De-Risking Hits Caribbean Banks", 31 Intl Enforcement Law Reporter. Allan Wright, Central Bank of "De-Risking and its Impact: The Caribbean Perspective", January 2016. Juan Carlos Schmid, "How Much Anti-Money Laundering Effort is Enough? The Jamaican Experience", IADB Policy Brief No. IDB-PB-242. Bank for International Settlements, Correspondent Banking, July 2016.

[5] CPMI, (BIS) Consultative Report, October 2015.

[6] FATF was established in 1989 by the G7 as an inter-governmental body to develop measures, set standards and promote implementation of these measures to combat money laundering, and subsequently in 2001, terrorist financing as well. To achieve international compliance with its AML.CFT standards, FAFT has a network of 9 FATF-style regional bodies (FSRBs), including the Caribbean Financial Action Task Force (CFATF), in addition to its own 37 members, observers and associate members. FATF monitors compliance through the FSRBs that conduct rounds of mutual mutual assessments to identify risks within countries and make recommendations to address these risks. See http://www.fatf-gafi.org/countries/.

particularly if their local counterparts do not offer in their view, sufficient evidence or guarantees of compliance with basic Anti-Money Laundering (AML) requirements.

1.3. Several of the factors identified by the BIS report for withdrawal of CBRs apply to Caribbean countries. In fact, as of May 2016, the "de-risking" phenomenon had resulted in at least 16 banks in the Caribbean losing their CBRs, with additional withdrawals expected by the end of the year. While a number of these banks have secured new CBRs, these new relationships involve more complicated relationships and higher costs for CB transactions. De-risking has severely affected a diverse set of countries in the region including the Bahamas, Belize, Jamaica, and the OECS. Some Caribbean countries present an increased reputational risk due to the presence of a significant offshore banking sector.

1.4. Credit Unions have been affected as well, as KYC and source of funds collected "over the counter" have come under increasing scrutiny, particularly those credit unions providing remittances services. In addition, to the extent that customers cannot open accounts at commercial banks, and move to credit unions, these institutions are under increased scrutiny for money laundering.[7] .

1.5. CBRs are crucial for Caribbean countries to enable the flow of remittances, provide access to credit or other financing, and to facilitate business operations for multinational corporations including Foreign Direct Investment. The loss of CBRs has a negative, potentially devastating developmental impact, as this may increase financial exclusion in the region, reduce trade flows, hamper the ability to obtain payments for services provided to foreigners (e.g. tourists), and overall compromise the current and future global competitiveness of Caribbean businesses[8]. The resulting termination of CBRs has contributed to growth of the shadow banking sector which also operates illicit or illegal activities, as well as a return to cash transactions, further fueling the perception of the region as high-risk for financial crimes.

1.6. In two public statements on de-risking in (October 2014 and June 2015), the FATF has recommended that international banks adopt a Risk-Based approach. In other words, each bank must assess their money laundering and terrorist financing risk and implement measures consistent with the risks identified. This will mean in reality that the level of supervision will be dependent on the *perceived* risk of respondent bank clients,

1.7. The local financial institutions in the region find it difficult to keep track of the latest developments vis a vis global rules governing international financial transactions, including AML/CFT standards, which are updated by FATF on an ongoing basis. It is also a serious challenge to fund on an individual basis the necessary training, staffing and operational upgrades needed in accordance with the standards, or to advocate and communicate the changes being undertaken to be fully compliant.

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[7] See KPMG, 14th OECS Credit Union Summit, "De-risking Practices and Implications for Credit Unions, and Solutions", September 15, 2016.

[8] The IDB has commissioned a study to assess the cost of the loss of CBR in Belize, specifically in the areas of trade financing, remittances and wire transfers. The study focuses on verifying; i) if these types of transactions are still available; ii) if and by how much the cost for these transaction has increased; and iii) if de-risking has increased the associated transactional costs. The study is expected to be completed by December 2016.

1.8. Undoubtedly, some of the root causes of de-risking lie outside of the control of the countries that are affected by it. For example, conflicting messages coming from regulators in the US and Europe have been flagged as one of the triggers for de-risking, and so has the termination of CBRs based on a consideration of risk versus return i.e. the level of business (income from correspondent banking).

1.9. However, there are steps that can be taken to improve the perception of the risks in a given jurisdiction. These actions have been mostly focused on the public sector, improving AML/CFT regulations, working only with regulators and supervisors. The private sector has not been a central part of compliance efforts at a country level. But as the IMF, the BIS and others such as the World Bank have highlighted, coordinated efforts by the public and private sectors are needed to mitigate the risk of financial exclusion and the potentially negative impact on financial stability. This includes a more precise understanding of the specific risks in each jurisdiction, a more effective implementation of AML/CFT policies and improved internal and external communication of the overall performance of the financial and non-financial sectors in relation to FATF requirements.

1.10. Specifically, such an approach should seek to: i) strengthen a country's level of compliance with international AML/CF standards,[9] by improving the way in which financial institutions, namely banks, implement those standards; and ii) improve private – public collaboration in developing and implementing AML/CFT solutions. In addition, because de-risking depends not only on *actual* risk but also on *perceived* risk, governments and financial institutions in affected countries should more effectively communicate their ongoing efforts to reduce risk. Interviews conducted by the IDB suggest that such a communication gap exists and that there is significant room for improvement. Finally, IT solutions may play a critical role in achieving better AML/CFT compliance and supervision, while reducing costs both for the public and private sector.

1.11. While some differences exist in terms of needs on a national level, the project intends to take a regional and a realistic approach, based on proportional compliance i.e. adoption of and adherence to standards based on level of risk.

2. THE INNOVATION PROPOSAL

A. Project Description

2.1. The overall objective of this project is to increase the level economic activity by micro, small and medium-sized enterprises and individuals by increasing financial transparency in Caribbean countries. The specific objective is to help prevent and mitigate the risk of loss of Correspondent Banking Relations in the Caribbean region.

[9] In this respect, it is important to underscore that, while Caribbean countries generally comply with the FATF standards at an aggregate level, compliance with specific FATF recommendations on Customer Due Diligence (CDD) and Beneficial Ownership is often low. The FATF assesses countries' compliance with its recommendations according to a 4-point scale: 1) non-compliant (NC); 2) partially compliant (PC); 3) largely compliant (LC); and 4) compliant (C). A country can be non-compliant or partially compliant on one or more FATF recommendations and yet not be subject to any of the FATF enhanced monitoring or grey/black listing processes. This is the case for the beneficiary countries of the proposed project, which are not subject to the FATF enhanced monitoring process nor appear on any FATF list, and yet have low level of compliance (NC or PC) with some key recommendations focusing on CDD, KYC and Beneficial Ownership, which affect the perception of risk among international banks.

2.2. To do so, the proposed project will work in three areas.

1. **Strengthen the implementation of international financial integrity standards by governments** in the beneficiary countries. This component will be supported financially by the IDB through the technical cooperation facility RG-T2670, financed by the Transparency Fund. IDB activities will complement those of the Caribbean Financial Action Task Force (CFATF)[10] .

2. **Strengthen the technical capacity of financial institutions (banks and credit unions)** in the beneficiary countries to conduct customer due diligence (KYC and KYCC) and adopt best practices for the collection of Beneficial Ownership information. This aspect of the project will be financed by the MIF. This aspect of the project will be implemented by the Association of Supervisors of Banks in the Americas (ASBA), in collaboration with the Caribbean Association of Banks (CAB) and the Caribbean Confederation of Credit Unions (CCCU).

3. **Improve coordination between the public and private sector to more efficiently** and effectively address de-risking, and **design a strategy for both jointly to more effectively communicate on an ongoing basis with external stakeholders** (e.g. international banks and foreign governments) about measures taken to strengthen financial integrity. This will be implemented by ASBA and jointly funded by the MIF and the IDB.

2.3. **Innovation**. Although there are a number of drivers common to de-risking in the Caribbean, the decision to terminate a CBR is an independent business decision undertaken after an assessment of the industry in the context of a specific country. Therefore, there is no one solution that will be necessarily effective for the entire region. The proposed project will employ a cross-cutting public-private sector approach that utilizes the strengths of the different project partners to help produce systemic changes in the industry via training, technology, standardization, and information-sharing among all stakeholders. The project takes a practical approach, based on proportional compliance, i.e. compliance based on level of risk.

The challenge of lowering compliance costs while building trust and navigating thorny regulations is one the MIF is uniquely able to undertake. This is due to the MIF's history of success in building access to markets and finance, its reputation as a convening power in the region successfully bringing together diverse groups of stakeholders to achieve a common goal, and its track record within the IDB Group of offering effective and targeted technical assistance, complementing the Bank's efforts. The MIF has also supported previous work on AML and KYC in the context of remittances. Between 2007 and 2009, the MIF collaborated with the World Bank and the Center for Latin American Monetary studies (CEMLA) and committee of central banks and regulators who developed General Principles for Remittance Services. The principles were subsequently endorsed by the G20.[11] Upon completion of the principles, the MIF

[10] The Caribbean Financial Action Task Force (CFATF) focuses on assisting the states of the Caribbean and Central America (CARICOM countries, the overseas British and Dutch territories, El Salvador, Venezuela and Guatemala) to implement common AML/CFT standards in line with FATF. See www.cfatf-gaflc.org. The Caribbean Financial Action Task Force (CFATF) conducts mutual assessments on FATF compliance and helps countries address compliance gaps and risks identified.

[11] See http://siteresources.worldbank.org/INTPAYMENTREMMITTANCE/Resources/New_Remittance_Report.pdf

worked with the World Bank on a guidance note for implementation of this approach for banks (including their correspondent relationships).[12].

2.4. **Component I: Strengthening the Implementation of International Financial Integrity Standards**. **IDB: US$ 200,000**. This component will help countries to strengthen compliance with international financial integrity standards, and particularly with the FATF recommendations. The focus will be more specifically on those recommendations that are more likely to trigger or affect de-risking, such as those focusing on KYC, KYCC, Customer Due Diligence (CDD), and Beneficial Ownership. The activities be based on the well-established and proven work done by the IDB in the area of financial integrity (project RG-T2224), and which will include: i) Conducting in-depth National Risk Assessments; ii) Adopting National Action Plans to address identified risks; iii) Updating laws and regulations well ahead of FATF evaluations to ensure compliance; iv) Strengthening institutional frameworks against AML/CFT, focusing on ensuring the effectiveness of these frameworks, in view of the new FATF evaluation methodology requirements; and v) Developing a communication strategy to disseminate the results of policy reforms adopted. These activities will complement similar work being done by the CFATF more broadly in the Caribbean, which conducts mutual assessments on behalf of FATF, and conducts training for the public sector.[13]

2.5. The project will dedicate funds to a ''regional public awareness raising and an advocacy initiative on de-risking building on work done in the region by Jamaica Nationals Building Society (JNBS). This will include a project website, building on the newly created - http://www.caribbeanderisking.com. This website aggregates content on AML/CFT topics..[14]

2.6. **Component II: Strengthen the technical capacity of financial institutions to comply with international financial integrity best practices**. **MIF: US$165,000; CDB: US$50,000; Counterpart: US$ 290,000.** This component will support targeted training activities for compliance officers and other relevant staff at banks and other financial institutions in the beneficiary countries. The objective will be to ensure that financial institutions adopt the highest standards related to CDD, KYC and Beneficial Ownership information relative to the risks they face. Training for banking supervisors will also be undertaken.

2.7. There are common training needs that will be addressed, so that similar regulatory standards are applied in the beneficiary countries.[15] Results of the National Assessments completed as part of Component I or by other donors such as the World Bank will guide content at a country level. This will level the playing field to avoid the migration of business to financial institutions that are less permissive on AML/CFT

[12] See section on Application of General Principles - at http://www.fomin.org/home/knowledge/developmentdata/remittances/advisoryservices.aspx

[13] CFATF will be administering a grant of $4.5 million euros pledged by the EU for AML/CFT national assessments, legislative reform etc. for its member countries, which includes the British and Dutch overseas territories in the Caribbean.

[14] The website has been developed by Jamaica Nationals Building Society, which has the largest remittances business in the Caribbean, and has been severely affected by de-risking. JNBS, has been a leader in building awareness about de-risking in the region, through information-sharing and high-level discussions with governments in the region as well as external regulators.

[15] Based on feedback from the region, training is needed not only in AML/CFT, but also in topics such as data analytics to strengthen compliance and enterprise risk management.

requirements; however, some aspects of the training will also be tailor-made to take into account particularities of each participating country as well as the specific needs of each participating financial institution. Finally, training will also consider needs of employees who may be more exposed to risks of AML/CFT such as compliance officers or client relationship personnel. Subject matter experts on AML/CFT and with intimate knowledge of the Caribbean financial system will be providing the training. Training curricula will be constructed so that beneficiary institutions see improvements over the short-term in their ability to conduct due diligence and to monitor both clients and transactions through the life of the account.

2.8. This component will also help local financial institutions find cost-effective compliance solutions that will not have a major effect on their bottom lines. A study on cost-benefit analysis of different solutions will be done so financial institutions can evaluate and potentially integrate them in their operations. This will include analyzing the feasibility of Information and Communication Technology (ICT) to lower costs of compliance with increased due diligence requirements.

2.9. **Eligible Financial Institutions.** Any financial institution subject to AML/CFT laws will be eligible to participate in the training and activities organized by this project Institutions will be able to join during the first 6 months of project execution, as long as they commit to contribute resources towards the cost of their training program.

2.10. **Component III. Improve coordination between the public and private sector. MIF: US$ 60,000; CDB: US$200,000; Counterpart: US$50,000.** The objective of this component is to improve coordination between financial sector regulators and financial institutions in beneficiary countries, through workshops and other activities, to jointly identify gaps and lines of action to prevent and mitigate the effects of de-risking. All key stakeholders (regional associations e.g. the Caribbean Association of Banks [CAB]) will be brought together and will have representation in a Project Steering Committee that will also be a source of strategic guidance for the project. The Committee will be instrumental in serving as a public-private discussion forum to produce a unified interpretation of AML/CFT and other regulations. The MIF will play a key role in facilitating these discussions.

2.11. In this component, the Steering Committee will be tasked with developing a regional approach to the de-risking problem, which will incorporate the activities in this project and provide a path to coordinating with other regional and national initiatives. This will be the first activity in the project.

2.12. This component will also design and operationalize a strategy to communicate more effectively and in a more targeted fashion with external stakeholders (e.g. international banks and foreign governments) on an ongoing basis, on measures taken by both beneficiary governments and financial institutions to strengthen financial integrity.

2.13. **Project Beneficiaries**. This project will target local financial institutions – local banks and regulated and unregulated credit unions – with cross-border CBRs, as well as credit unions who depend on local commercial banks as their connection to international banks for cross-border transactions. The project will focus primarily on the Bahamas, Belize, Jamaica and the OECS, which have had their CBRs severed, or whose CBRs are at risk. These local institutions targeted are challenged in terms of understanding what is

required in terms of compliance with FATF rules, and find the costs prohibitive to tackle issues of AML/CFT training and lobbying with regulators on their own. It is expected that the project will benefit at least 30 local financial institutions directly, as well as banking regulators from the OECS and the 9 CARICOM countries that are members of ASBA.. The region will also benefit more broadly from the program through the Caribbean Association of Banks (CAB) with 52 members, as well as the Caribbean Confederation of Credit Unions (CCCU), with 300 members. Both of these institutions, along with the CFATF will be partners of the project.

B. Project Results, Impact, and Monitoring and Evaluation

2.14. Results. The expected impact of the project is a more transparent and therefore stronger financial system in the Caribbean, a key pillar to economic development, by helping to decrease the risk profile of Caribbean jurisdictions as well as local Caribbean banking and other financial institutions. In terms of results, it is expected that: a) at least 30 institutions in the Caribbean will significantly improve AML/CFT compliance and supervision; b) regulators and banking supervisors will increase their knowledge of the AML/CFT financial regulations and their implications, as well as their ability to monitor compliance; c) governments in the beneficiary countries will improve regulatory frameworks consistent with FATF rules; and d) the perception of the Caribbean as high risk with respect to money laundering will be significantly improved through the dialogue established in the project.

2.15. Some of the concrete indicators the project will track include: the retention of current CBRs or establishment of new CBRs; expanding standardization, and the number of compliance officers and other FI personnel trained; and expansion of project activities to other Caribbean economies during the life of the project. These key indicators are included the Project Results Matrix The only baseline indicator that will be constructed at the beginning of the project is the number of existing correspondent banking relationships open in the beneficiary countries.

2.16. Monitoring. The project will be monitored using the relevant key performance indicators identified in the corporate results framework, and the baseline data established at the beginning of the project. Reporting will be done through the bi-annual MIF Project Supervision Report (PSR).

2.17. Evaluation. The project will have both a mid-term and a final evaluation. The mid-term evaluation will be conducted at the mid-point of the project, or when 50% of resources have been disbursed, whichever occurs first. The mid-term evaluation will include: i) an assessment of the results of project activities so far, including the training results, and the impact on compliance; as well as ii) the effectiveness of the Steering Committee vis a vis public-private dialogue. The final evaluation will be conducted at the end of the project' implementation period and will focus primarily on the extent to which the project achieved the intended results and impacts. It will compare the baseline indicator on CBRs against actual project results. The project team, together with the project coordinator will develop evaluation plans for both the mid-term and final evaluations. Possible questions to be included in the final evaluation could include: i) To what extent has the combined public and private sector approach of this project been successful in mitigating de-risking in the beneficiary countries; ii) To what extent has the training program results in qualitative improvements in compliance and the ability properly address KYC and KYCC issues in beneficiary institutions?

3. ALIGNMENT WITH IDB GROUP, SCALABILITY, AND PROJECT RISKS

C. Alignment with IDB Group

3.1. De-risking and the termination of CBRs are an important issue for the IDBG. At the March 2016 meeting of the IDB Caribbean Governors, President Moreno stated that, “our priority will continue to be supporting most vulnerable economies.”[16] There is also alignment with IDB sector-specific principles. First, if high compliance costs are viewed as a non-trade barrier, the current situation is negatively affecting the region’s competitiveness for trade and compromising future integration efforts. The project would fall under the IDB’s efforts to lower regulatory costs through streamlined management processes[17] as well as to overcome capacity gaps[18]. In addition, the IDB has a history of intervening in underperforming markets or sectors to mitigate risks and secure access to finance for vulnerable sectors, including SMEs[19]. By ensuring a well-functioning financial system in the Caribbean, there is greater opportunity for economic development and integration into global trade and financial systems.

3.2. The project is also consistent with the country strategies for the beneficiary countries and the IIC business plan. The operation is aimed at strengthening institutional capacity of FI beneficiaries and their ability to improve financial transparency. It is aligned to the Updated Institutional Strategy of the IDB as it addresses the 3 identified development challenges (Social Exclusion and Inequality, Low Productivity and Innovation and Lack of regional economic integration) as they are tightly bound together[20]. This project was prepared following the bank’s principles of responsiveness, leverage and partnerships, strategic alignment, innovation and knowledge. It is also aligned with the 2016-2019 IIC’s priority business areas, as it will help FIs to reach end-beneficiaries effectively by helping Caribbean FI’s to improve their compliance with financial regulations, which will strengthen SME finance mobilized in the region

1. Scalability

3.3. This project will test for the first time a particular public-private model to mitigate the de-risking problem in four Caribbean countries. While several key analyses of the de-risking problem advocate a joint public-private sector approach, the IDBG is the only

[16] http://www.iadb.org/en/news/news-releases/2016-03-04/caribbean-regional-governos-analyze-economic-outlook,11414.html

[17] Integration and Trade Sector Framework Document,” IDB, June 2016, pg. 23

[18] Ibid., pg. 34.

[19] Support to SMEs and Financial Access/Supervision Sector Framework Document,” June 2014 pg. 38

[20] Updated Institutional Strategy “The three development challenges are tightly bound together. Each can be thought of as a cause and consequence of the other. Inequality and exclusion hinder productivity; low productivity inhibits integration; and lack of integration aggravates inequality. In periods of macroeconomic turbulence, the three become even more tightly bound. Tackling these challenges, therefore, requires a multidisciplinary approach. To ensure that development gains are preserved and that Latin American and Caribbean nations continue to converge toward middle class societies, it is clear the Region must reduce inequality and poverty, increase productivity and innovation, and improve economic integration”; IDB, March 2015.

multilateral donor who is taking this approach to date. This project has been designed with the ultimate objective of expansion to other Caribbean economies to foster a strong region-wide standardization of regulations and a common approach to de-risking.

3.4. To ensure scalability and sustainability, the project will work with key regional bodies, who will be training partners and beneficiaries of the project through their members to carry on project activities, namely training and advocacy. These bodies will be represented on the Steering Committee. Training materials, expertise and connections will be properly transferred to these and other key domestic players. It is expected that the JNBS website will continue well beyond this project. As a result, the project will contribute with documents that will include country assessments, podcasts of training and other materials produced during implementation that can be used and serve as reference for other Caribbean countries

3.5. Moreover, the mechanism for ongoing dialogue between the public and private sectors in the Caribbean and the external regulators on the other is being established as a permanent structure to maintain ongoing discussion and promote common understanding. Lessons learned in this intervention will be documented and systematized a final case study to serve as a reference for future interventions in the rest of the Caribbean countries.

2. Project Risks

3.6. The main risks identified for this project are the following:

3.7. **Coordination**. Because of the diversity of actors involved in the project, coordination between the different entities involved may hamper the achievement of project goals. Mitigating Factor: This risk will be mitigated by establishing points of contact among the beneficiaries of the project and managing coordination through the IDB, which has a track record in playing this type of facilitating role. The approach to coordination in the project will be outlined in the Operations Manual.

3.8. **Lack of commitment on behalf of beneficiary governments**. The past trajectory of the Bank’s work on financial integrity suggests that it may be challenging to ensure sustained support of behalf of the beneficiary entities for work in this area. Mitigating Factor; To mitigate this risk, the team will proceed first with the countries that demonstrate a clear commitment in writing to advance with the proposed project activities. The beneficiary countries cited are the most affected by de-risking and have demonstrated a strong interest in IDBG assistance. In addition, the key regional organizations representing financing institutions – e.g. CAB, CCCU and CFATF have expressed interest in participating in this project, and will be providing formal letters of commitment as project partners. Commitment will also come from the realization of the high cost to be paid from lack of compliance.

3.9. **Lack of commitment from private sector actors, namely financial institutions.** Financial Institutions receiving training may not adhere to implementing new CDD, KYC measures as these will represent more costs and they may be perceived as requirements that do not facilitate business relationships. Mitigating Factor: The project will be devoting resources to conduct on analysis on options for reducing compliance.

3.10. **Lack of Availability of qualified trainers to provide high level training** to Caribbean FIs. Consistent training in FATF standards will be required over the life of the project for local FIs. Some training will also have to be tailored to specific local contexts. Mitigating Factor: ASBA has extensive experience in conducting training in AML/CFT requirements and also has the ability to mobilize international experts as needed for more tailored training.

3.11. Overall, these risks are clearly offset by the potential benefits of the project. As noted, de-risking is a reality in the Caribbean region more than a threat. Its costs in terms of: loss of business, decreased access to foreign markets, increased financial exclusion of the underserved, and ultimately the movement of legitimate transactions underground have yet to be fully evaluated. However research suggests that they are likely to be quite significant.[21]

4. INSTRUMENT AND BUDGET PROPOSAL

4.1. The project has a total cost of US$1,263,000 of which US$465,000 will be provided by the MIF, US$200,000 by the IDB; and an estimated US$186,158 in cash and in-kind by ASBA.. The Caribbean Development Bank has expressed interest in co-financing the project and has proposed a contribution of US$250,000. This is subject to approval of the CDB Board on December 8th. Finally, financial institutions will contribute US$250,000[22]. This counterpart contribution will be exclusively directed to supporting their training needs as described in Component II. The project execution period will be 36 months and the disbursement period 42 months.

4.2. Given the nature of this project and its regional and sectorial scope, it is expected that more financial institutions and/or their respective industry associations will also be interested in joining the project. The executing mechanism will allow their participation with additional resources.

[21] See for example, Allan Wright, "De-risking and its Impact: The Caribbean Perspective" Caribbean Centre for Money and Finance Working Paper #1.

[22] It is projected that 30 financial institutions will join the project with an estimated amount of individual contributions of US$9,500.

	MIF	IDB	Counterpart (ASBA)	Counterpart (Financial Institutions)	Co-financing (Caribbean Development Bank))	Total
Project Components						
Component 1: Strengthening the implementation of international financial integrity standards.	-	$200,000	-	-	-	$200,000
Component 2: Strengthen the technical capacity of financial institutions to comply with international financial integrity best practices	$165,000	-	$90,000	$200,000	$50,000	$505,000
Component 3: Improve coordination between the public and private sector	$60,000	-		$50,000	$200,000	$310,000
Project Manager	$150,000	-	-	-	-	$150,000
ASBA Coordination			$96,158			$96,158
Monitoring & Evaluation	$20,000	-	-	-	-	$20,000
Ex-post Reviews	$20,000					$20,,000
Contingencies	$50,000					$50,000
Grand Total	$465,000	$200,000	$186,158	$250,000	$250,000	$1,351,158
% of Financing						

5. EXECUTING AGENCY AND IMPLEMENTATION STRUCTURE

A. Project Executing Agency(s) Description

5.1. The IDB through the Institutional Capacity of the State Division will be the in charge of the execution of Component I of this project, which focuses on compliance support to the public sector. This will be done in collaboration with the CFATF, which is also providing similar support to the public sector more broadly in the Caribbean, including the British and Dutch overseas territories that are not members of the IDB.

5.2. The ASBA will be the executing agency for Components II and III of this project and will sign an agreement with the Bank. Formally incorporated in 1999, ASBA acts a regional hub throughout the Americas to disseminate knowledge, share information, and promote dialogue between its members while also providing support, services, and training that enhance the technical capacity of local, national and regional Banks. Given that the organization includes the national central banks and entities responsible for financial sector regulation and supervision for target countries in this project, ASBA is uniquely poised to execute the project objectives and significantly contribute to lowering the high-risk perception of countries in the Caribbean.

5.3. ASBA is composed of 41 financial sector regulatory and supervisory agencies from 36 different countries in Latin America, the Caribbean and Spain. In addition to playing a pivotal role in promoting dialogue between its members, ASBA is able to generate regulatory guidelines to ease with local regulation approval. ASBA also coordinates the relationship of its members with key international organizations dealing with international financial standards like the Bank of International Settlements (BIS), FATF and the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes and the European Commission. The core funding of ASBA is provided by its members to finance essential operations and a region-wide training effort focused on prudential regulation issues.

5.4. ASBA has successfully implemented one MIF project in 2008 -- RG-M1146 "Strengthening Banking Supervision for Improved Access to Financial Services", This project developed regulatory guidelines for banking supervisors on topics like consumer protection, financial inclusion and micro-credit. More recently a project on regulation and the role of new technologies (RG-M1257) was approved in September 2016. In this project ASBA will come up with regulatory recommendation to facilitate the incorporation of new business models, products and services which are the result of financial innovation, as block chain.

5.5. ASBA has been an excellent partner and allowed MIF and IDB group to reach regulators and financial sector stakeholders in an efficient manner. MIF Project resources have been managed properly as reflected in their own audited financial statements and MIF's ex-post reviews.

5.6. The Office of the Secretary of ASBA will be the co-execution unit for this project. It has the capacity and experience to execute activities under its responsibility as well as to manage project resources.

B. Implementation Structure and Mechanism

5.7. This project brings together a diverse group of regional actors to implement a first -of-its kind public-private sector intervention to mitigate de-risking in the Caribbean. Therefore the coordination of activities to be executed in collaboration with stakeholders, as well as the coordination with ASBA will be key.

5.8. The project will have a Steering Committee, with one representative each from the IDB Group, the Caribbean Development Bank, CFATF, CAB, and the CCCU. The Steering Committee will be responsible for the strategic direction of the project, and will meet on a quarterly basis throughout the life of the project.

5.9. Component I: For this Component, the IDB will hire consultants in accordance with the active policies and procedures within the Bank to execute activities. All technical support at country-level will require a letter of request or a non-objection letter from the Government as appropriate. A request has already been received from Guyana. The activities of this component will be executed under the supervision of the Institutional Capacity of the State Division.

5.10. Components II and III: A small project Unit will be established in ASBA and the necessary structure to implement the activities of these components in close coordination with CAB and CCCU. Both CAB and the CCCU will appoint a liaison person from their institution for the project.

5.11. In order to help ensure smooth coordination between ASBA and the IDB, a project manager will be hired by the MIF to be the focal point for all project activities, ensure timely project execution and to liaise on an ongoing basis with project partners (including the CDB) and stakeholders. The project manager will be posted in IDB Headquarters within the IDB/ICS unit, and will be responsible for the following tasks: a) Communication and awareness-raising about the project in the Caribbean and de-risking in general; b) Assisting the IDB and ASBA in their role as facilitator for the public-private dialogue mechanism to be established under Component III; c) Organizing and acting as secretary for meetings of the Project Steering Committee; d) gathering all necessary information from IDB and ASBA to prepare and present a Project Status Report within thirty (30) days after the end of each semester. The PSR

will contain information on the progress of project execution, achievement of milestones, and completion of project objectives as stated in the results matrix. The PSR will also describe issues encountered during execution and outline possible solutions. Within ninety (90) days after the end of the execution term, the Executing Agency will submit to the MIF a Final Project Status Report (FSR) which will highlight results achieved, project sustainability, evaluation findings, and lessons learned.

5.12. The project manager, with input from ASBA and, the IDB will develop an overall work plan of activities to be done, including an execution plan, and a milestones table. The project manager will also refine the project's Plan of Operations.

6. COMPLIANCE WITH MILESTONES AND SPECIAL FIDUCIARY ARRANGEMENTS

6.1. **Disbursement by Results and Fiduciary Arrangements.** ASBA will adhere to the standard MIF disbursement by results, procurement and financial management arrangements as specified in Annex V.