# “Financial Inclusion Objectives, Benefits, Challenges”

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It is indeed a pleasure to be here with you today at the ComplianceAid’s Fourth Caribbean Anti-Money Laundering & Financial Crimes Conference. I am delighted to address you on the topic of Financial Inclusion Objectives, Benefits and Challenges.

**How many people remember a time when money was stored in a jar that you buried in the backyard?** Coming from societies that fashion ourselves modern, it sounds like a practice from our ancient past. For residents of Cat Island, a population center in The Bahamas’ southern region, access to cash deposits is no laughing matter. It has only been 10 years since Cat Island got its first commercial bank. One local business owner remembers his father’s practice of keeping money under the mattress. While the business owner uses the local bank to operate his gas station today, his father, when he was a farmer some 20 years ago, had to find creative ways to store his cash. Some on the island resorted to burying their cash in the backyard.

It was not so long ago that Cat Island operated bankless, and the residents haven’t forgotten. After all, there are still a few other islands that have no local access to financial services.

The essence of financial inclusion is access: access to useful and affordable financial products and services that meet the needs of individuals and businesses delivered in a responsible and sustainable way.

Financial inclusion found its way on to the agenda of the International Monetary Fund (IMF), United Nations (UN) and the financial stability board more than a decade ago. In addition, more than sixty (60) governments have put this as a target in their National Development Plans. The

Bahamas' National Development Plan dedicated several sections to financial literacy and financial inclusion.

From an individual and business point of view, when speaking about access, financial inclusion covers access to transaction accounts operated by regulated payment service providers in order to:

1. make and receive payments and safely store some value;
2. serve as a gateway to other financial services, including:
    a. small savings product
    b. money transfer facilities
    c. insurance products
    d. small loans and overdrafts

"Financial inclusion is a key enabler to reducing poverty and boosting prosperity, which is why the World Bank has called for Universal Financial Access (UFA) by 2020. According to World Bank data, "around 2 billion people [around the world] don't use formal financial services and more than 50% of adults in the poorest households are unbanked."

Many Bahamians still don't have access to deposit accounts, including large segments of our immigrant community. Barriers to account-opening include distance from a financial service provider, lack of necessary documentation papers and lack of trust in financial service providers.

In emerging economies, more than 200 million micro, small and medium-sized enterprises (MSMEs), in the formal and informal economy, lack adequate financing to thrive and grow. MSMEs cite a lack of collateral and credit history, and business informality as main reasons for not having an account, according to the World Bank.

The Bahamas might be a large global financial center, but these statistics are still very relevant to us, given the uneven wealth distribution in the country. Acklins Island, for example, another one of our rural southern islands, is currently unbanked.

This island has a small population with limited economic opportunities; however, there is a micro tourism industry in Acklins with tremendous potential.

The Bahamas is the largest fishing area for bonefish in the world, with nearly 20,000 acres of bonefishing flats. Some estimates value the local industry at $500 million. Acklins is home to the country's second largest bonefishing flats, but it is unable to maximize its participation in the industry. The fact that the island is unbanked is only one factor, but it is an important one. The inability to access even the most basic financial services, stifles the growth of this high value micro sector and overall investment and development on the island.

As an archipelago, with approximately two dozen inhabited islands, the population of The Bahamas is spread across a vast seascape. 30% of the population lives in the Family Islands. This is our collective name for the less developed island communities outside of New Providence, where the capital is located. These communities in particular, need to feel the benefits of financial inclusion.

If we achieve our objectives they will, for financial inclusion is an idea rooted in equality. It is targeted towards under-served people and communities, and has the power to galvanise the global community as an economic imperative.

At least 7 of the 17 UN Sustainable Development Goals include access to financial services in their related targets. These goals are elimination of poverty, zero hunger, gender equality, economic growth, industry, innovation and infrastructure, and reducing inequality.

- Target 10c, for example, calls for a concerted reduction in the transaction costs of migrant remittances as a means of reducing inequality. Many migrant works in the Caribbean depend on remittances as source of poverty alleviation. In The Bahamas, the Haitian community channels a large amount of remittances back to Haiti. To Jamaica, remittances are a vital contributor to GPD.

- Importantly, target 10.6, also speaks about reducing inequality, calls for the enhanced representation and voice of developing countries in decision making in global international economic and financial institutions.

It is fitting for this to be the theme of the conference today, because the reality is, anti-money laundering regulations and efforts to counter terrorism financing are the latest mechanisms placing tremendous pressure on efforts to achieve important financial inclusion objectives.

**Today, I will speak in detail about one of the most pressing threats: De-risking, which covers the troubling withdrawal of correspondent banking services from the region. Then I will share two perspectives from The Bahamas, on efforts to achieve financial inclusion objectives overall: the digital economy and financial resilience.**

## DE-RISKING: Challenging the Historical Bias

Before I dive into the topic of de-risking, I beg your indulgence because I must touch on a sensitive subject that is very personal to the region. We don't often speak about it publicly, but I am confident it is deeply felt by those professionals working in the region

I am referring to **a historical bias that contributes to the "high-risk" perception of the region.**

This view is so corrosive that some international banks are accused of ending correspondent banking relationships without evidence of wrongdoing on the part of the regional bank and without giving clear reasons for their actions. This is an untenable situation given the threat posed by the de-risking trend to our economic survival.

The negative perception of the region exists despite the significant amount of investment – investment of time, effort and funds – made by regional governments to ensure we are compliant with international standards and best practices. We are committed to international compliance not just because it's in our economic interest, but also because we share a common set of values with our bilateral and multilateral partners. We continue to do so every day, even as the tide of regulation shifts with the identification of new and emerging threats.

As a region, our laws fully reflect the view that money laundering and the financing of terrorism are financial crimes with adverse economic effects. It is not as though we are fighting against this notion. Where our laws have been found outdated or insufficient, we are updating them.

In Parliament back home today, the Government is in the process of enacting:

- The Financial Transaction Reporting  Amendment Act, 2018; and
- The Proceeds of Crime Amendment Act, 2018
- In recent months, we tabled the Travellers Currency Declaration (Amendment) Bill, 2018.

In the year 2000, The Bahamas introduced a flood of new regulatory and financial sector legislation, which included The Banks and Trust Companies Regulation Act, 2000, The Financial Intelligence Unit Act, 2000, The Proceeds of Crime Act, 2000, and The Financial Transactions Reporting Act, 2000, among others.

The financial sector governing laws created avenues for international cooperation by Bahamian financial sector regulators with their foreign counter-parts, and international cooperation by Bahamian courts in civil matters.

In 2003, amendments to financial sector laws allowed for risk based supervision by Regulators some nine years before the recommendations by the Financial Action Task Force on Money Laundering were amended to reflect same.

**I share some of our legislative initiatives to emphasize: There is no respected regional government or institution that is not committed to mitigating the adverse effects of criminal economic activity, and promoting integrity and stability in financial markets. These are shared goals of the developed world and of the developing world.**

And yet, it often appears as though countries in the region are not treated as cooperative partners: as if our business models are inherently harmful or corrupt in some way. This perspective could not be further from the truth.

The hasty move by the European Union Code of Conduct Group to include The Bahamas on its recent list of "non-cooperative jurisdictions for tax-purposes" is only the latest example of how this harmful perspective has major reputational and economic consequences for countries of the region. Fortunately, I can report, The Bahamas this week was recommended for removal off the list, and we expect this to be taken up without discussion at the next meet in May of the EU Economic and Financial Affairs Council (ECOFIN). By their own admission, "The Bahamas has done everything it needed to do, and now it is the EU's time to act".

As a country, and as a Caribbean region, we have to reckon with a historical bias that is denying us treatment as sovereign equals with common goals.

We can all agree that historically our entry into the financial services sector as an offshore banking jurisdiction was once based upon tax avoidance, a practice that was openly embraced even by the developed world, in jurisdictions like Delaware, New Jersey and Switzerland. But yesterday's mark of shame, once freely applied to jurisdictions believed to be tax havens, is not applicable to the Caribbean of today. The whole world has evolved since then: Business models have shifted over time and the Caribbean has shifted with it.

I can speak for The Bahamas in saying: We are not a tax haven. We are a transparent, compliant and cooperative wealth management jurisdiction, providing competitive services to international financial markets for financial services. We compete on the strength of our services and the quality of our professionals.

We have become active participants in the international regulatory framework with a demonstrable commitment to the shared goal of tax compliance. Of course, most of us are in progress with our efforts, but we have never wavered on our values or shirked from our commitments.

**There is skepticism about our financial practices and an intense focus on the Caribbean by authorities in advanced economies that is convenient because of our size and relative vulnerability. But, it is also rooted in a failure of the international community to let go of the past and to treat countries like The Bahamas as progressive, cooperative, sovereign partners who share the same goals. We must reckon with this historical bias, as it has the power to undermine our collective efforts. Simply put, it is time for advanced economies to take the mark off the back of the Caribbean.**

## Overview and Impact of De-Risking

That being said, let's go into some specifics about de-risking and the challenges posed to financial inclusion.

1. In the Caribbean, foreign banks have developed a reduced risk appetite. That would be none of our concern if it wasn't causing them to pull out or pull back from the region. Materially, it has impacted our cornerstone correspondent banking relationships (CBRs) and critical access to money transfer operations.

2. International banks now face higher fines, penalties and litigation costs for failing to comply with a variety of new laws and regulations, including complex Anti-Money Laundering and counter-terrorist financing (AML/CFT) requirements. Due to more aggressive and high profile enforcement, there is also fear of reputational loss from being identified as conduits for money laundering or financing of terrorism. In addition, the ability to generate income from the deposits held in correspondent accounts have diminished considerably. These all impact profitability and the attractiveness of maintaining certain business relationships.

3. Instead of managing their risks, however, in accordance with guidelines issued by FATF, for example, the reality is, many banks have pegged the region as too high risk and are choosing to avoid the risk all together. They are terminating relationships, restricting

business or wholesale moving out. Too often, this is happening with no underlying evidence to suggest any systemic malfeasance within the jurisdictions from which they are withdrawing.

This is a crisis for the region. The IMF recently noted: “Correspondent banking is like the blood that delivers nutrients to different parts of the body. It is core to the business of over 3,700 banking groups in 200 countries.” This is a sentiment shared by the Caribbean Association of Banks, which has been an important advocate on the issue.

Correspondent Banking Relationships, or CBRs, provide vital access to the international financial system for The Bahamas and the Caribbean. They are essential for people and businesses to complete international payments. They support the trade in goods and services between countries, and the movement of capital and financing for businesses.

For service-based economies, that are largely dependent on international trade, the impact is all encompassing. We are talking about ordinary transactions engaged in on a daily basis: purchasing goods and raw materials, shopping online, wiring funds such as college tuition and receiving payments from international vendors.

In 2016, The Bahamas was one of the countries impacted when 16 banks located in the Caribbean region lost relationships with correspondent banks. In its 2016 industry survey, The Central Bank of The Bahamas found that 26 per cent of licensed institutions – covering commercial banks, trusts, credit unions and money transmission industries – lost at least one correspondent banking relationship in The Bahamas in the three years prior.

Fortunately for The Bahamas, the withdrawal of CBRs has not reached a critical level to threaten the overall stability of the banking sector; however, de-risking has gained traction with foreign banks across the region, and left unabated, threaten the very livelihoods of Caribbean people.

The IMF considers the Caribbean to be “the most severely affected region due to the size of its economies, degree of informality and institutional and regulatory challenges, among other factors.”

From the CAB's assessment, "the loss of correspondent banking relationships could render the Caribbean region unbankable and ultimately destabilize all sectors of the economies." If that is not a threat to financial inclusion, I don't know what is.

The IMF notes, among the many negative impacts anticipated from the disturbing trend are:

- "the promotion of financial exclusion rather than inclusion,
- shrinkage of the financial sector,
- thriving underhand economies,
- increased use of unregulated payment options, and
- a barrier to attaining [several Sustainable Development Goals]," which I referenced earlier in my introduction.

These are not simply future threats. Countries are feeling it now. In 2015, the Bank of America cut its correspondent banking relationship with Belize Bank and Atlantic Bank International in Belize, compromising their ability to execute US dollar bank drafts, wire transfers and foreign currency transactions.

Collectively, these actions have unintended consequences: They drive consumers to smaller informal providers, promoting a parallel underground, cash-only system, ripe for fraud and money-laundering. The irony is, the more we exclude the more we raise the risk profile of our jurisdictions.

There is no getting around the fact that CBRs are critical enablers for economic and financial transactions, and international trade in goods and services in the Caribbean. In other words, they are absolutely vital enablers for sustaining the Caribbean region's growth and development.

## Action Needed on De-Risking Threat

To a certain extent, de-risking is being addressed with the appropriate level of seriousness at the international level. Important studies to coalesce the issues have been undertaken by the IMF, World Bank and Commonwealth Secretariat. But we cannot rest on our laurels until we have succeeded in reversing the trend, and uprooting those historical biases. Leveraging our collective strengths as a region and raising awareness continues to be an important need.

The Bahamas supports the position issued by the CARICOM Central Bank Governors Technical Working Group on De-risking in their 2016 working paper: Global regulators and international standard setters (FATF, CPMI, OSFI, UST, etc.) need to address the complexity of regulations and risk exposures which are contributing to biases in the incentive structure against certain classes of business; and the costs of ensuring that international transactions do not violate national sanctions and prohibitions in the USA and elsewhere. Global regulators need to take specific steps toward a long-term solution to this urgent policy challenge.

While Caribbean governments and regulators are receptive to continued improvement in their AML/CFT frameworks, we will continue to call for clarity from outside regulators and authorities to identify the specific gaps in Caribbean regulatory systems that pose "high-risk" concerns, and to provide clearer guidance on how correspondent banks should manage their risk rather than severe-unnecessarily their regional relationships.

A balance must be struck between AML/CFT regimes, financial inclusion objectives and the sustainable development interests of small island developing nations.

## THE DIGITAL ECONOMY

### The Future of Banking is Digital

Despite these challenges, and in the face of other threats, Caribbean countries continue to be forward looking when it comes to financial inclusion. The Bahamas, in particular, has set a target of moving substantially toward a digital cashless economy, so that our most vulnerable communities in the Family Islands and our low income populations in particular, are guaranteed access to financial services. As a government we are fully mobilized to achieve a digital populous and a digital economy.

Several factors are at play here:

- The situation was exacerbated this year when the Royal Bank of Canada announced branch closures in two of our rural communities: North Andros and Long Island. Both of these communities relied almost exclusively on RBC's commercial banking services.

- Unfortunately, branch banking is an expensive undertaking, and the Caribbean has been a challenging environment to work in. Banks are seeing compressed returns on weaker credit portfolios and pressure on their operating costs.

- Across The Bahamas, the branch network for commercial banks is decreasing. And if we are really looking to the future with open eyes, we should expect that to continue.

- Globally the banking strategy is digitization, and banks are moving at breakneck speed.

The archipelagic structure of the country, added to a small total population and uneven population distribution, only complicates the situation for The Bahamas further.

The banks are still realizing tremendous profit margins in The Bahamas, but the overall dollar value in profits, given the economies of scale, are not always competitive. Foreign institutions balance their global and regional asset allocation based on head office level decisions. It is often cold economic calculations that determine what capital is available for investments locally.

Some banks are not just signaling the future of banking. They are moving full steam ahead on that trajectory, forcing their customers to get on board or get left behind, and feeling justified, based on the level of internet and mobile penetration in The Bahamas.

We understand this position. But in our view, the banks could be more progressive and socially engaged to help facilitate the cultural adoption of technology. In The Bahamas we still have challenges with financial literacy, public mistrust of financial institutions and phobia about using electronic transactions.

Indeed, in 2013, mobile penetration was at 84%, but this implies a level of technological adoption and comfort that is not the cultural reality. Bahamians might be well accustomed to mobile usage for social and entertainment purposes, but the leap to digital banking is exactly that: it is still a leap for a population that still has large segments without access to basic deposit accounts.

We do have to bite the bullet as a culture to realize the promise of technology. And that promise has always been allowing a person with a phone and access to the internet, the ability to use their phone as a digital wallet to securely conduct transactions, in a relatively secure and traceable manner. This would really set the table for a different kind of Bahamas in so many ways.

As a government we have to get at the forefront with financial education, regulatory reform, and service delivery to help our people rapidly move through the adoption curve.

## The Government's Leadership Role

The **Government's leadership role** is important to helping the country to shift to this digital economy. In fact, it is the primary role of the Government: Championing an enabling environment through its regulatory work, investment policies, and its very own service delivery.

We can't champion ideas that we are not adopting ourselves. The more we allow the population to interact with us digitally, the more we facilitate the necessary behavior shifts. We can't sit by while innovation is taking place all around us. As governments, we too must be leaders in the whole digital revolution for our people.

In The Bahamas we have already started to aggressively push our processes online, including tax payments for VAT, business license and real property tax, as well as driver's license payments. We will soon be engaging the range of national stakeholders with a view to creating a robust and secure national cradle-to-grave identification system, as part of our e-Government initiative.

This will come with some privacy concerns from the public, as Jamaica has experienced with their plans for a similar initiative. These concerns, however, are at the forefront of our mind, and we are addressing them as part of the project's actual design. As with Jamaica, "this source of identification will be considered as conclusive for the purpose of customer due diligence, not only for banks but for all businesses which require customer identification and verification."

## The Central Bank's Efforts

This leads me to my final point on the Digital Economy: **The Central Bank's efforts**.

As the leading monetary policy agency in The Bahamas, the Central Bank of The Bahamas is also tackling a number of these pressing financial inclusion issues. In January, the Central Bank joined the International Alliance for Financial Inclusion (AFI) as a principal member. The AFI network is comprised of 104 member institutions, representing 91 countries worldwide.

The Government is fully supportive of the Central Bank's proactive approach.

Its efforts to increase the number of Bahamians with access to deposits accounts by reviewing **Know Your Customer (KYC) requirements** is an important one.

The current KYC regime makes the process for opening a Bahamian bank account unnecessarily complicated. It is nearly impossible to open a domestic bank account without at least 2 forms of national identification (ID); one of which must be a Bahamian passport. It is easier for a Bahamian to fly to Miami and open a US bank account, which can be done in 15-minutes, opposed to the 2-hours it takes back home for a domestic account.

The Central Bank is developing a simplified customer due diligence (CDD) procedure for low-value e-money products to ease this concern. It is in active discussions with commercial banks on how they can exercise discretion and flexibility in the due diligence process, when they are able to assess low money laundering or terrorist financing risks from such clients. The Central

Bank has dedicated an entire section to assisting persons without standard identification documentation to access the formal financial sector.

The Central Bank is also spearheading the **Bahamas Credit Bureau Project**. The project is several years in the making; however, this year, Parliament enacted the Credit Reporting Bill, clearing the way for the long standing project to move forward earnestly. For the new administration, seeing it swiftly implemented is a high priority and will advance our financial inclusion objectives.

Lastly, the Government is very pleased to see the Central Bank examining the possibility of a **digital Bahamian currency**. The Central Bank Governor in a recent address on the Digital Currency Initiative said: "The Bank envisions an accelerated shift towards the use of electronic payments, with a concurrent reduction in cash transactions. This would be facilitated in part, by a digital version of the Bahamian dollar, [an] appropriately further evolved regulatory system, and inter-operability among new channels for the provision of payments services."

Within 24 to 30 months, the Central Bank plans to roll out a piloted version of a digital domestic currency in several underserved rural communities that will likely serving as case studies. The new digital identification system, an essential precursor, will be piloted for use within the financial services sector as part of this initiative.

As you can see, there is much work to be done. The Bahamas is wasting no time. We are in the trenches, building the infrastructure, doing the work to create our digital economy.

We will continue to review our regulatory and legal AML/CFT regimes to ensure that those residing in our boarders have access to the formal financial sector's products and services through facilitating the widest net for financial inclusion.

## FINANCIAL RESILIENCE

## Managing Natural Disasters

The last major point I want to make is about **financial resilience** and the management of natural disasters. I could not skip over the big bad force of nature that has the power to undermine all of our collective efforts in the region. I am sure the threat of catastrophic natural disasters has given many of you sleepless nights, especially those of you in the insurance sector.

Financial resilience and financial inclusion go hand in hand. If our governments are bankrupted by natural disasters we can't achieve any of our objectives, much less financial inclusion.

In 2004, Hurricane Ivan hit Grenada, a state of only 133 square miles in size. It devastated the nations' main economic driver, the nutmeg crop, and left two thirds of the population without sufficient housing. Total damages were estimated around US$900 million, equivalent to 200% of national GDP at the time.

In 2004, Grenada's example would have seemed extreme, but not anymore. Small Island Developing States, or SIDS, across the world have suffered disaster impacts with losses equally as significant in terms of their GDP.

When Hurricane Maria hit Dominica in 2017, total damages included US$931 million and losses of US$382 million, which amounted to 226 percent of the 2016 GPD.

For The Bahamas, Hurricane Matthew in 2016 cost the Government upwards of $600 million, which is equivalent to 40% of The Bahamas' national budget. The damage from Hurricane Frances, the storm that wrecked the island of Grand Bahama in 2004, had a 14 percent impact on The Bahamas' GDP and associated costs totaled $1.2 billion.

The Caribbean Catastrophe Risk Insurance Facility (CCRIF), launched in 2007, is the first ever multi-country risk pool. It was set up by 16 Caribbean countries with support of the World Bank and now provides member governments with immediate liquidity following disasters. The

Bahamas has benefited, somewhat, from this insurance. We are, however, actively pushing CCRIF to improve its service by better meeting the unique needs of each territory.

As a government we are looking at a range of options to ensure that we are positioned to respond to and address national disasters and emergencies when they arise, including a disaster savings fund set aside every year in the budget; possible increased reinsurance; or disaster bonds as are used elsewhere in the world. And it may be a combination of all of these.

To ensure the viability and resilience of SIDS, the notion of financial inclusion has to be extended globally to ensure that these vulnerable nation-states can easily access the financial products and credit to enable them to respond to natural catastrophes and thereby remain productive contributors to the global economy.

## CONCLUSION

The importance of financial inclusion as a vehicle to enable and empower people and communities cannot be overstated. There are some serious threats to our survival as a region, not just the physical and financial toll of natural disasters, but also the threats to financial inclusion like the practice of de-risking.

Notwithstanding, the Caribbean region itself is resilient. And we are accustomed to making things happen for ourselves under some very extreme circumstances. The presence of these challenges means opportunity abounds: opportunities to innovate, to modernize, to quantum leap; opportunities to achieve economic growth and sustainable development by meeting financial inclusion targets.

In The Bahamas later this year, I am pleased to announce we will host our national AML/CFT conference to think through many of the challenges and opportunities on the topic, including financial inclusion. The event will be held from Sunday, September 16 through Tuesday, September 18, 2018 at the Baha Mar Convention Center located in Nassau. This Conference is intended as the first in a new annual series and will become the Bahamian flagship event for improving our national capabilities in AML/CFT.

At The Bahamas AML/CFT Conference in September, we will gather some of the brightest minds to contribute to our national dialogue. The conference will engage international and local expertise including representatives from Thomson-Reuters, the International Monetary Fund, along with academic scholars.

With this event, The Bahamas is strengthening its positioning as a thought leader in the global fight against money laundering. It will help our stakeholders to improve their capacity to protect against financial crime, and to stay plugged into the global dialogue.

We invite you to join us in The Bahamas from September 16 through 18 to contribute to meaningful discussions regarding AML/CFT. More details regarding registration will be available in May through the Central Bank.

As I said in the beginning, it is important for the financial inclusion conversation to be front and center as we continue to develop AML/CFT mechanisms. It ensures that we keep ordinary people at the forefront of our minds even as we aggressively work to mitigate criminal conduct in the financial sector. We cannot let these efforts compromise access to financial services for ordinary people who are simply trying to make a living, run their businesses and go about their affairs as law abiding citizens with every right to financial inclusion.

The Caribbean region is not sitting back while these urgent demands bang at our door. We are hard at work, organizing, mobilizing, taking action: project by project, programme by programme, building the infrastructure and rolling out services. We must keep the financial inclusion conversation at the forefront by increasing financial literacy, and continuing to meet clear and measurable targets along the way.

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