

Governor's Speech
Payment Systems and Correspondent Banking in the SAARC Region

NIBAF, Islamabad

16th May 2016

Ladies and Gentlemen: Assalam-o-Alaikum and Good Morning.

I am privileged to welcome all the distinguished participants and speakers on behalf of SBP, my colleagues and SAARC friends at the seminar who have gathered here today to exchange views on payment systems and correspondent banking.

At the outset, let me share with you that since the 10th SAARC summit in 1998, the SAARCFINANCE Group has been a key gateway that has allowed regulators to gather at the forum and share their experiences about the efficacy of the existing policy framework, identify the emerging challenges, and brainstorm ideas to tackle these challenges. Over the years, the SAARCFINANCE Group has taken a number of constructive initiatives to achieve the objective of regional economic cooperation and trade facilitation. Since the year 2002, State Bank of Pakistan has been organizing seminars under the umbrella of SAARCFINANCE; these events have covered topics as diverse as monetary policy, SME financing, BASEL-II, consumer protection, risk management and internal audit.

One of the major objectives of the SAARCFINANCE Group is to strengthen payment mechanisms to boost intra-regional trade. To achieve this, I feel it is imperative that regulators, especially those from our region, interact and coordinate with each other to address the policy gaps and bottlenecks impeding intra-regional trade, commerce and remittance flows.

During the last few years, State Bank of Pakistan has taken a number of steps to improve the efficiency of our domestic payment system. We have a comprehensive Payment Systems Act, a well functioning RTGS, and a Branchless Banking system that provides payment related services to ordinary customers through an expanding network of around 300,000 agents. We also have the Pakistan Remittance Initiative (PRI) that is playing a significant role in facilitating overseas Pakistanis in sending home remittances through legal channels, in partnership with commercial banks. Pakistan has also implemented the International Bank Account Number (IBAN), which plays an important role in integrating various domestic and cross border payment systems. Recently, we have also issued regulations governing the security of internet banking services offered by commercial banks to ensure that international security standards are being implemented in the banking system.

Ladies and Gentlemen!

The world is now more inter-connected; this offers not only benefits but also poses risks for our banking and payment systems. Due to rapid technological innovations, consumers are now especially demanding instant funds transfer facilities, both at domestic and cross border levels. We need to understand these changing consumer preferences and find ways to address them. This is vital, not only for the growth of domestic and regional trade and commerce, but for facilitating home remittance transfers by overseas nationals as well. At the same time, we cannot afford to ignore the risks related to anti money laundering and counter financing of terrorism (AML/CFT) that are increasingly being faced by financial institutions in today's world.

You are all aware that correspondent banking is the contractual relationship between banks that provide payment services for each other. However, as

identified by international stakeholders like BIS and the World Bank, correspondent banking relationships are weakening due to various factors, such as higher costs and increased KYC requirements, especially for firms operating in risky jurisdictions. As a result, smaller banks in weak jurisdictions have suffered the most.

To address these weaknesses, Central Banks of the SAARC region must work together and support banks in their respective countries in addressing these challenges. This can be done through policy development that supports mutual coordination and communication with regards to sharing of customer due diligence information and effective compliance with AML/ CFT regulations, as recommended by international bodies. The regulators can, therefore, focus on the following broader areas:

First, A risk-based approach needs to be adopted to identify, assess and understand money laundering and terrorist financing risks in the area of correspondent banking, and the corresponding AML/CFT measures that are largely implemented but still needs more reinforcement. Banks also need to be more proactive in their customer due diligence by gathering and sharing sufficient information among themselves, in a timely manner.

Second, as highlighted by the Financial Stability Board (FSB), the reduction of correspondent banking relationships or what is now commonly called DERISKING has implications for financial inclusion in general and for the remittance transfer business in particular. This is important because financial inclusion has lately emerged as a priority policy objective for many central banks in developing countries across the world. Therefore, regulators need to take steps to address this issue.

And finally, the importance of modern and robust domestic payment systems in strengthening and complimenting correspondent banking in a particular jurisdiction cannot be overemphasized. Some recent events related to security breaches in banking sector underscore the importance of enhanced safety and security measures, especially in the domain of international payments.

Ladies and Gentlemen,

Now, there is no denying that a direct implication of these measures will be an increase in the cost of correspondent banking services and consequently cost of transactions to tackle this, innovative solutions need to be explored. For example, in the SAARC region, we can create a correspondent banking model that will facilitate smaller banks and provide services at lower cost, while also adequately managing risks. One way of doing this can be to designate one bank in each of our countries that will provide correspondent services to all the respondents in their respective jurisdictions. These designated correspondent banks can then interact with each other to facilitate payments and settlements within the SAARC region sounds primitive but can be good starting point. This, I am sure, will reduce transaction costs, while at the same time mitigate risks, especially those related to anti money laundering and counter financing of terrorism.

Finally, I will request all of you to take full advantage of this seminar to discuss the challenges facing the correspondent banking business and then suggest regulatory measures that can be adopted to strengthen the regional correspondent banking framework. A modern, intra-regional payment and trade facilitation system is paramount for our collective economic growth and prosperity.

I wish you a pleasant stay in the beautiful city of Islamabad and hope you find time to explore the surroundings.

Thank you.