Anti-Money-Laundering Measures Challenge Global Banks in Mexico

By Michael Perez

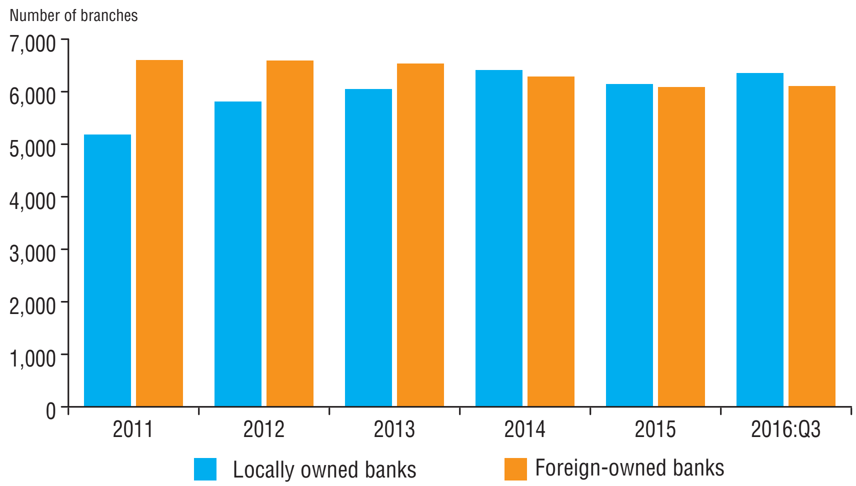
Global banks are taking precautions in Mexico amid tighter anti-money-laundering regulations that have prompted some institutions to leave the market. The total number of foreign-owned bank branches operating in Mexico fell 7.4 percent between 2011 and 2016, partially the result of stricter regulations. Meanwhile, the number of domestically owned branches grew 22.5 percent (*see chart*).

The stricter standards were promulgated in 2012 by the Financial Action Task Force, an independent intergovernmental agency that works to combat money laundering. The measures mandate that banks and regulators identify, assess and take action to mitigate money laundering and terrorist financing risks.[1]

Proximity to the U.S. makes banks, especially those with branches or correspondent relationships on both sides of the border, attractive to launderers attempting to move funds inconspicuously between the two countries. Correspondent banking involves one bank (the correspondent) providing a deposit account, liability account or related service to another bank (the respondent).

The measures also subject domestic and foreign-owned banks in Mexico to strict oversight by U.S. regulators, who seek to prevent illicit funds from entering the U.S. financial system.

Chart 1 Foreign-Owned Bank Branches in Mexico Edge Lower



SOURCE: Mexican National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores).

Longstanding Concern

Anti-money-laundering concerns are not new or unique to Mexico. Illegal financial outflows from Mexico are sizable, estimated at over $50 billion per year.[2] However, while the revised standards are improving practices, they are costly. For many foreign banks, the added expense and potential legal liability can't be justified given the amount of money earned in Mexico.

As a result, many foreign banks are withdrawing or consolidating financial services in Mexico by closing branches and accounts and channeling investment toward improving their existing infrastructure. This makes it difficult for local customers, who are losing access to convenient branches where they can safely deposit cash and finance their businesses.

The effects are felt on the U.S. side of the border as well. Some U.S. banks have terminated remittance services between the U.S. and Mexico and have begun refusing to accept deposits from third-party money transmitters. This raises the cost of sending money across the border.

The foreign banking retrenchment also makes it harder for regional and small Mexican banks to process payments involving dollar clearing. Most of Mexico's biggest banks can use their U.S. units to clear dollars. But the exit of foreign correspondents from the Mexican financial system has forced smaller banks, which lack the economies of scale to clear U.S. currency on their own, to look for often more-expensive alternative clearing partners abroad.

U.S. regulators' heightened money-laundering vigilance prompted Mexico's oversight change. "Know your customer" rules are of particular importance to banks. They restrict the size of account balances, the cumulative value of transactions and/or the channels to access funds for "low-information clients"—those without the documentation to open a traditional, unrestricted account.

Mexican authorities are working to remedy the unintended consequences of foreign-bank closures and consolidations. Mexico's publicly owned development banks, for example, have augmented their presence to provide banking services to the financially underserved in communities deemed too risky by commercial banks.

To support dollar clearing, Mexico's central bank has developed a domestic payment system to settle same-day payments in dollars for Mexican banks. The system allows banks to process payments safely and efficiently and improves traceability.

Notes

[1] See "International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation," Financial Action Task Force, February 2012 (updated October 2016).

[2] See "Illicit Financial Flows from Developing Countries: 2004–2013," by Dev Kar and Joseph Spanjers, Global Financial Integrity, December 2015.