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# ANTI-MONEY LAUNDERING REGULATION, CORRESPONDENT BANKING, AND THE ADVERSE ECONOMIC EFFECTS FOR THE U.S.-MEXICO BILATERAL RELATIONSHIP

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## EXECUTIVE SUMMARY

In 2020, financial payments and transfers between Mexico and the United States totaled more than \$750 billion. Foreign direct investments (FDI) between the two countries accounted for \$14 billion with the stock of U.S. FDI in Mexico totaling \$101 billion and the stock of Mexican FDI in the United States totaling \$21 billion. In addition, the United States imported \$393 billion in goods and services from Mexico, and Mexico imported \$307 billion from the United States. Financial remittances to Mexico totaled \$51.6 billion in 2021, including \$49 billion from the U.S.

These financial flows have substantially occurred through correspondent banking relationships involving hundreds of thousands of daily transfers between banking institutions in Mexico and the United States. However, since the Patriot Act of 2001, U.S. regulators have targeted correspondent banking between these two countries as part of an intense anti-money laundering (AML) and anti-terrorist financing (CFT) campaign. This study examined the basis for this continuing campaign, and we have concluded that these efforts have become ineffective, misplaced, and costly for the American economy.

First, the regulatory AML/CFT regime for correspondent banking is ineffective.

- ◆ Worldwide, government authorities manage to seize a very small share of the estimated \$1 trillion to \$3 trillion in funds laundered annually.
- ◆ Criminals often attempt to evade “Know Your Customer” rules for banks by using bogus identities and creating multiple tiers of shell companies, trusts and foundations registered across several countries and hiring “nominee” directors and officers with no knowledge of an account’s ultimate owners or beneficiaries.
- ◆ Criminals also increasingly use “shadow banking” arrangements beyond banking regulation, including internet-based transfers, blockchain cryptocurrency payments, and complex financial derivatives, as well as informal transfer systems that shift funds anonymously through networks of intermediaries in currency exchanges, stock brokerages, casinos, and auto dealerships, and through cash purchases of real estate, gems, and precious metals.



Second, focusing AML/CFT regulation on U.S.-Mexican correspondent banking is misplaced. The International Monetary Fund (IMF) found that over the last decade, Mexico put in place a mature AML/CFT system based on international standards, and the World Bank commended Mexico for its transaction databases and monitoring of cross-border transfers.

- ◆ The Basel Institute on Governance also found that the AML/CFT system in Mexico is superior to 60 other countries, including Cayman Islands, Thailand, Saudi Arabia, and Hong Kong.
- ◆ Further, the Tax Justice Network (TJN) found that Mexico's banking system is more transparent than those in 109 other countries, including the U.S. Japan, Canada, and Israel. The TJN also found that Mexican banks are "tiny" players in international financial transactions, handling less than one-tenth of one percent of those transfers worldwide.

- ◆ Mexico's broad conformity with international AML/CFT standards and practices and the transparency of its banking system support a review of its current risk status by regulators of correspondent banking.

Third, current AML/CFT regulation of correspondent banking between Mexico and the U.S. entails significant economic costs as Mexican and U.S. banks responded by "de-risking": They reduced their correspondent banking relationships or ended the services to avoid possible fines and reputational damage and to preclude attracting broader scrutiny from banking regulators.

- ◆ Correspondent relationships declined 30.5 percent in Latin America and 12.2 percent in North America by 2020. Such relationships involving smaller and regional Mexican banks declined 34 percent, and the value of those transactions fell 8 percent even as those values increased in Brazil, Argentina, and other large Latin American countries.

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**Econometric analysis showed that the regulatory focus on correspondent transactions between U.S. and Mexican banks from 2012 to 2018 and the associated de-risking had significant adverse economic effects, ...reducing growth in the U.S. stock of FDI in Mexico by an average of**  
**\$1.4 billion in a given year.**



- ◆ Econometric analysis showed that the regulatory focus on correspondent transactions between U.S. and Mexican banks from 2012 to 2018 and the associated de-risking had significant adverse economic effects, slowing FDI from Mexico to the United States by an average of \$480 million in a given year, reducing growth in the stock of FDI in the United States by an average of \$3.3 billion in a given year, and reducing growth in the U.S. stock of FDI in Mexico by an average of \$1.4 billion in a given year.
- ◆ As a result, this focus on correspondent banking activity between the United States and Mexico dampened U.S. GDP growth from 2012 to 2018 by an average of 0.03 percent per-year for a cumulative slowdown in GDP growth of \$38.3 billion. Moreover, these GDP effects slowed U.S. employment growth by 41,000 jobs per-year or 285,000 jobs from 2012 to 2018.
- ◆ Econometric analysis also showed that the decline in correspondent banking relationships associated with misplaced U.S. AML/CFT efforts slowed Mexico's exports to the United States by \$74 billion from 2011 to 2021, dampening U.S. employment growth by 114,000 jobs.
- ◆ Current U.S. scrutiny of correspondent banking also impedes transfers of bulk dollars to U.S. banks from Mexican institutions collected from tourist spending, "pocket" remittances, payments to workers employed near the border, and cash seized from criminals.
- ◆ Finally, the decline in correspondent relationships impedes access to secure remittance transactions from the U.S. to Mexico for low-income people with marginal access to banking.

Despite Mexican banks and the Mexican government implementing AML/CFT controls and practices that generally meet international standards and requirements, regulatory scrutiny of cross-border financial services continues to disrupt trade and flows of foreign direct investment and some remittance transactions, imposing significant economic costs.



# Anti-Money Laundering Regulation, Correspondent Banking, and the Adverse Economic Effects for the U.S.-Mexico Bilateral Relationship

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## I. INTRODUCTION AND SUMMARY OF FINDINGS

The economies of the United States and Mexico are extensively interconnected through billions of dollars foreign direct investments, trade flows and remittance transfers. American and Mexican companies are active investors in each other's economies: In 2020, Mexico received more than \$12 billion in U.S. foreign direct investments (FDI), and Mexican FDI flows to the United States totaled nearly \$2 billion.<sup>2</sup> In 2020, the stock of Mexican FDI in the United States totaled nearly \$21 billion while the stock of U.S. FDI in Mexico was more than \$101 billion.<sup>3</sup> The United States and Mexico also are major trading partners. In 2019, Mexico imported \$307 billion in goods and services from the United States and exported \$398 billion in goods and services to the United States, trade flows equivalent to 3.3 percent of U.S. GDP and a remarkable 56.0 percent of Mexico's GDP.<sup>4</sup> In addition, remittances or direct money transfers from

abroad to people in Mexico totaled \$51.6 billion in 2021, including \$49.0 billion from U.S. residents.<sup>5</sup>

These extensive economic ties between Mexico and the United States involve hundreds of thousands of daily transfers of funds between financial institutions in the two countries, principally through correspondent banking relationships. Correspondent banking has been an essential part of the organization and practice of international commerce and finance for more than a century, under arrangements in which banks in different countries maintain accounts with each other and act as intermediaries or agents to service payments and transfers originating in one country and concluding in the other country. These transactions may involve the correspondent banks' own clients and customers, or a correspondent bank may act as a



third party to facilitate transactions for clients and customers of other financial institutions. Nearly all correspondent banking transactions involve electronic transfers, although a modest share involve bulk foreign currencies collected from payments by tourists, residents working near borders, proceeds from criminal activities seized by authorities, and a small share of remittances.<sup>6</sup> These bulk transfers of U.S. dollars from Mexican banks to U.S. institutions totaled \$6.3 billion in 2021.

Over the past decade, correspondent banking has been subject to strict regulatory requirements and oversight in many countries, including the United States and Mexico, based on international concerns about criminal organizations using the arrangements to launder funds and finance terrorism and other criminal activities across countries. Concerns about money laundering are well-based: Estimates by the United Nations and the World Bank of the volume of funds laundered in 2021 range from \$800 billion to more than \$3 trillion.<sup>7</sup> However, evidence and analysis indicate that focusing U.S. anti-money laundering (AML) efforts and steps to combat terrorist financing (CTF) on

correspondent banking, particularly between the United States and Mexico, has become ineffective, misplaced, and economically harmful.

The Money Laundering Act of 1986 was the first U.S. legislation that specifically criminalized the act of using proceeds from criminal activity in any financial transaction with an intent to conceal the source, ownership, or control of those proceeds, and the G-7 countries created the Financial Action Task Force (FATF) in 1989 to develop internationally accepted laws and strategies for fighting money laundering.<sup>8</sup> These international efforts to stem money laundering accelerated after the 9/11 attacks, when the Patriot Act directed that a wide range of financial institutions take steps necessary to “Know Your Customer” (KYC) by verifying the identity of anyone who deposits funds, owns a business opening an account, directs a foreign entity opening an account, or transfers \$10,000 or more.<sup>9</sup> Amendments to the Bank Secrecy Act in 2016 extended the KYC requirements to “beneficial owners” of new accounts, covering anyone with a 25 percent interest or more in an account’s assets or a company opening an account.<sup>10</sup>

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These approaches have especially targeted correspondent banking: The laws specifically direct that KYC requirements be applied to any person or entity with a correspondent account in the United States for a non-U.S. person or entity, bar correspondent accounts for foreign banks without a U.S. presence, and direct banks to apply special due diligence to foreign banks and clients. They also grant the U.S. Treasury authority to demand the records of any correspondent account, closedown any correspondent account, designate any foreign bank in a correspondent banking relationship as a “money laundering concern,” and exclude it from carrying out international capital flows.<sup>11</sup>

This approach has proved to be inefficient. There are no official statistics on AML/CTF enforcement, but one commentator estimates that more than 90 percent of laundered funds are undetected,<sup>12</sup> and others have estimated that AML/CFT enforcement manages to seize 0.1 percent to 0.2 percent of laundered funds.<sup>13</sup> As we will see, one reason is that criminals responded to the focus on correspondent banking by adopting stratagems that frustrate or avoid those regulatory efforts to oversee them for AML and CFT purposes. Criminals routinely endeavor

to thwart attempts to be identified as ultimate owners or beneficiaries by using bogus identity documents and secreting their funds through tiers of legally incorporated and licensed shell companies, trusts, and foundations that cross many jurisdictions. These entities also employ “nominee” directors and officers with no link to or knowledge of the ultimate owners and beneficiaries, and those sham directors and officers can issue anonymous bearer shares ultimately transferred to the actual owner or beneficiary.

Sophisticated money launderers also regularly bypass banking systems altogether by using “shadow banking” arrangements such as direct internet-based transfers, blockchain-based cryptocurrency payments, complex financial derivatives, and serial equity crowdfunding of sham projects. Drug cartels, terrorist groups

and other money launderers also use “Informal Value Transfer Systems” to move funds anonymously through networks of intermediaries outside formal banking systems. These non-bank networks include currency exchanges, stock brokerage accounts, casinos, auto dealerships, insurance trading

companies, gems and precious metals, internet banking, and wire transfers that evade AML/CTF requirements and enforcement focused on

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banks and correspondent accounts.

The particular emphasis of U.S. AML/CFT regulation and enforcement on correspondent banking transfers between the United States and Mexico also is misplaced. For more than a decade, Mexican government and banking institutions have taken substantial and broadly successful steps that have sharply reduced the risk of money launderers using the nation's banks and correspondent banking arrangements. In 2018, IMF reported that Mexico had established a "mature" AML/CTF system based on a well-developed legal and institutional framework, including systems for real time monitoring of settlement payments, enforcement of identification standards, and cross-border information sharing.<sup>14</sup> The World Bank also commended Mexico's system of databases and monitoring of wire transfers in foreign currencies and cross-border transfers originating in Mexico and abroad.<sup>15</sup> The main caveat noted by these international bodies regarding Mexico involved enforcement related to non-banking institutions.

Other international bodies also have noted the effectiveness of Mexico's current AML/CFT protocols and operations, especially compared to other countries. The Basel Institute on Governance (BIG) evaluated country efforts to discourage and discover laundered funds based on compliance with FATF recommendations and goals and on regulators' ability to pierce bank secrecy.<sup>16</sup> Its evaluation of Mexico in 2021 found that the country's efforts to prevent money laundering and terrorist financing were superior to those in 60 other countries, ranging from Cayman Islands, Thailand, and the Philippines to Russia, Saudi Arabia, and Hong Kong.

Similarly, the Tax Justice Network (TJN) conducted intensive analysis of cross-border financial transactions and secrecy covering 133 countries, including legal provisions for secrecy in banking transactions and their administration.<sup>17</sup> The TJN analysis for 2020 found that Mexican banking was more transparent than banking in 109 other countries, including the United States, Japan, Canada, and Israel.<sup>18</sup> The analysis also assessed the likelihood of

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laundered money flowing through each country by measuring the extent of cross-border financial flows involving financial institutions in each country. TJN reported that Mexican banks were involved in less than one-tenth of one percent (0.09 percent) of all international payments and transfers and that 47 countries handled larger shares of those transactions than Mexico. The much larger players in cross-border payments and transfers included Ireland, Hong Kong, Switzerland, France, and Japan with 25 to 50 times as many transactions as Mexican financial institutions; Singapore, the Cayman Islands, and Germany with 50 to 100 times as many such transactions; and Luxembourg, the United Kingdom, and the United States with 137 to 237 times as many transactions as Mexican institutions.

Targeting AML/CFT regulatory efforts on financial transactions between the United States and Mexico is inefficient, given Mexico's status as a very minor factor in cross-border financial flows as well as the robust state of its AML/CFT arrangements and practices. These regulatory efforts also could produce greater results by targeting non-banking entities and the tiers of anonymous sham companies, trusts and foundations located across nations, as such entities have displaced correspondent banking relationships and banking generally as unwitting or occasionally deliberate facilitators of money laundering and terrorist financing.

The current U.S. regime of AML/CFT regulation of correspondent banking between the United States and Mexico also has become economically costly by making transfers between U.S. and Mexican institutions more difficult, time-consuming, and expensive. For many banks, the continuing regulatory focus on correspondent banking transactions also has raised a prospect of serious financial penalties and reputational damage if, for example, regulators charge that a bank failed to penetrate a network of shell entities laundering funds. Banks that maintain their correspondent banking arrangements also invite broader scrutiny by banking regulators, further increasing their operating costs compared to competitors. Many banks have responded to these developments by eliminating their correspondent banking operations or limiting them to important long-time customers and clients. This "de-risking" process has further increased the costs of cross-border payments and transfers for companies and individuals.

Since the volume of the financial transactions associated with foreign direct investments, trade, and remittances between the United States and Mexico is very large, this de-risking process has had adverse economic effects. To assess those effects, we analyzed the extent of the decline in correspondent banking relationships across many countries, including Mexico and the United States. The Bank of International Settlements reports that the number of active



correspondents declined 30.5 percent across Latin America and by 12.2 percent in North America.<sup>19</sup> Worldwide, the number of active correspondents declined 25 percent since 2011 (a notable exception is the sharp rise in correspondent banking relationships involving China).<sup>20</sup> This de-risking has especially impaired correspondent banking relationships involving smaller banks, which declined 34 percent in Mexico. The value of correspondent banking transactions involving Mexico also declined 8.2 percent despite the country's extensive AML/CFT reforms and compliance and even as the value of those transactions increased in Brazil, Argentina, Chile, and Panama.

Next, we applied econometric analysis to assess whether these effects on correspondent banking involving Mexico affected trade volumes and flows of foreign direct investments and remittances. To do so, we analyzed changes in those payments and transfers involving Mexico as compared to countries in which correspondent banking did not contract to comparable degrees. We found that the regulatory focus on correspondent banking transactions between the United States and Mexico is associated with significant adverse effects on foreign direct investment and trade between the two countries.

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**...reductions in correspondent banking are associated with a slowdown in annual FDI flows between the United States and Mexico in both directions.**

Foreign direct investment, especially from companies in advanced economies such as the United States to developing economies such as Mexico, is highly significant economically. FDI involves creating joint ventures with local companies in other countries or establishing foreign affiliates or subsidiaries in other countries; and these new operations typically include transfers of not only technologies but also management skills and operational knowledge that local companies can emulate and replicate.<sup>21</sup> FDI-based enterprises also stimulate new business for local firms that produce goods and services for the new enterprises. Further, these features of FDI-based modernization generate local income and so support employment, government revenues and growth in a developing economy such as Mexico.

FDI funding from the United States to Mexico and the repatriation of associated profits from Mexico to the United States all flow through banks in the two countries, and much of those flows have involved correspondent relationships. We should expect that the misplaced regulatory oversight of correspondent banking linked to AML/CFT efforts could adversely affect legitimate FDI-related flows between the United States and Mexico.



Our analysis found that the reductions in correspondent banking are associated with a slowdown in annual FDI flows between the United States and Mexico in both directions: These effects reduced Mexican FDI flows to the United States by an estimated \$477 million per-year from 2012 to 2018 and reduced the estimated stock of FDI in the United States in a given year by nearly an estimated \$3.3 billion. The effects on U.S. FDI to Mexico also were significant: The decline in correspondent banking was associated with an estimated \$1.4 billion average reduction in the U.S. stock of FDI in Mexico in a given year from 2012 to 2018.

The slowdown in Mexican FDI to the United States has meaningful economic effects. Our analysis found that it dampened U.S. GDP growth by an estimated 0.03 percent per-year from 2012 to 2018, for an estimated cumulative loss of \$38.3 billion or \$5.5 billion per-year.

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**\$38.3 billion or \$5.5 billion/year.**

The analysis also found that this impact dampened U.S. employment growth by an estimated 285,100 positions over those years or an average of 40,730 jobs per-year.

The analysis also showed that the decline in correspondent banking relationships associated with misplaced AML/CFT efforts reduced Mexican exports to the United States by \$74.3 billion over the decade from 2011 to 2021 compared to what would have been expected without the changes in correspondent banking. These adverse effects also are economically significant because a slowdown in trade flows also directly affects employment: The reduction in Mexican exports associated with the reduction in correspondent banking dampened U.S. employment growth by an estimated 113,830 jobs from 2011 to 2021.

Correspondent banking arrangements also are significant channels for remittances from the United States to Mexico. Mexico receives the fourth largest inflows of remittances in the world behind India, China and the Philippines and five times the global average as a share

of GDP.<sup>22</sup> As noted, Mexican households received \$51.6 billion in remittances in 2021, of which \$49.0 billion or 95 percent

came from the United States. Those remittances represent either the main source or an important source of income for more than 60 percent of the Mexican households receiving them.<sup>23</sup> While money launderers rarely use



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remittances to transfer criminal funds, many financial institutions in Mexico and the United States have withdrawn the service over the past decade as part of the de-risking strategies associated with AML/CFT regulatory scrutiny. The value of U.S. remittances to Mexico continued to rise as U.S. employment grew and immigrants became more skilled with age and

education; but the transparent and once competitive market for remittance transactions has become much more concentrated, reducing access and shifting more transfers to less reliable and sometimes more costly informal channels. As a result, the current regulatory focus on correspondent banking harms lower-income people in both countries.

## II. THE IMPACT OF AML/CFT REGULATION ON CORRESPONDENT BANKING

### *Statutory Basis for AML/CFT Regulation*

Government efforts to detect and deter money laundering have long focused on the banking system, since criminal proceeds accepted by a bank can be transferred easily for any purpose. The underlying statute in the United States is the Bank Secrecy Act (BSA) of 1970, which directed financial institutions to help detect and deter money laundering by keeping records of cash purchases of negotiable instruments and reporting transactions exceeding \$10,000.<sup>24</sup> The Money Laundering Act of 1986 followed as an amendment to the BSA, prohibiting anyone

from using the proceeds from specified crimes in any financial transaction with the intent of concealing its sources, ownership, or control.<sup>25</sup> Following the 9/11 attacks, efforts to detect and deter money laundering intensified around concerns about terrorist financing. The Patriot Act passed in October 2001 further amended the BSA by directing banks, thrifts, credit unions and other federally regulated financial entities to identify criminal proceeds through requirements to “Know Your Customer” (KYC).<sup>26</sup> The most recent amendment to BSA passed in January 2021 created an “ultimate beneficial



ownership” register to help detect money laundering through shell entities.

The KYC or “Customer Due Diligence” requirements are designed to help ensure that banks understand the nature and purpose of their relationships with their customers, including the types of transactions that involve them. These requirements comprise one of five “pillars of compliance” under the BSA.<sup>27</sup> The other four elements direct banks to 1) designate an officer with the resources, independence, and qualifications to administer the bank’s AML/CFT compliance program; 2) establish and implement a system of internal controls to ensure that all AML/CFT regulatory requirements are satisfied; 3) provide AML/CFT training tailored to the roles of each employee on an annual basis; and 4) conduct regular independent audits of audits. These five pillars provide a reasonable framework to regulate correspondent banking relationships and address money laundering, especially insofar as it occurs through those relationships.

### ***The Regulatory Focus on Correspondent Banking***

As noted, the KYC efforts established under the Patriot Act focus particularly on correspondent banking operations by specifically directing banks to apply KYC requirements to any person or entity maintaining a correspondent account in the United States for a non-U.S. person or

entity and barring correspondent accounts for foreign banks without a U.S. presence. The Act also direct banks to apply special due diligence to any foreign bank or client and grants the Treasury authority to demand the records of any correspondent account, close any correspondent account, and designate a foreign bank as a “money laundering concern” to signal U.S. banks to stop dealing with it.<sup>28</sup>

The focus on foreign banks and clients reflects the fact that a large share of money laundering involves cross-border transactions. The specific focus on the trade financing conducted through correspondent banking reflected a view that those cross-border financial flows accounted for a significant share of money laundering. As we will see, money launderers responded by creating networks of shell or sham companies, trusts and foundations that superseded correspondent accounts and other forms of trade finance and by migrating from banks to non-regulated or informal financial entities.

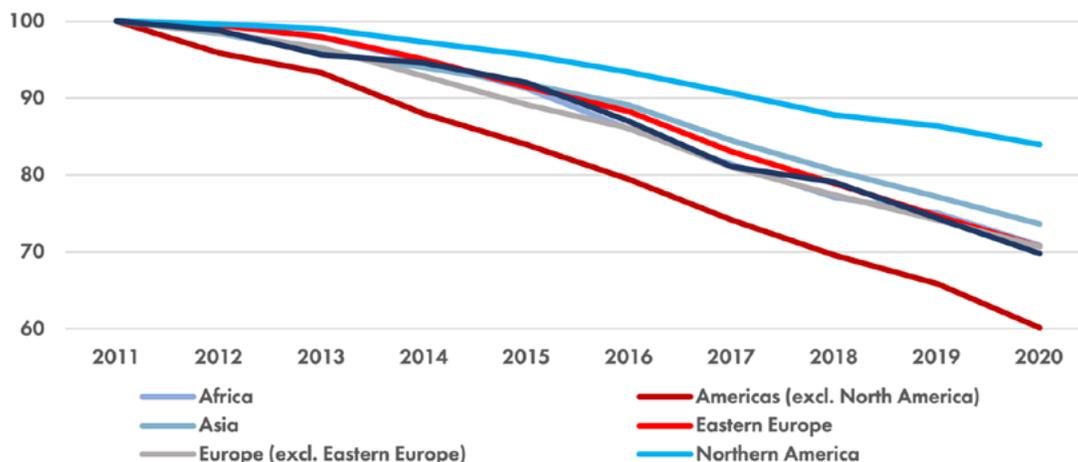
The focus of AML/CFT laws and enforcement on correspondent banking also led many banks to curtail their cross-border correspondent banking operations and thereby reduce the risk of unknowingly facilitating money laundering that could lead to fines and reputational damage and attract more general attention from bank regulators. This de-risking process began initially as a response to evidence that



drug cartels were moving large amounts of illicit money through banking systems. A decade later, some countries that had been high or significant risk environments for money laundering, including Mexico, had developed much more effective AML/CFT compliance regimes—and much money laundering had migrated away from direct transactions involving banks. Nevertheless, correspondent banking remains a focus of much AML/CFT operations, and the de-risking process has continued.

This de-risking of correspondent banking relationships affects every region in the world (see Figure 1, below). Overall, the numbers of active correspondents declined by about 25 percent from 2011 to 2020, with one notable exception: Correspondent banking relationships involving Chinese banks increased by a remarkable 3,355 percent from 2009 to 2016.<sup>29</sup>

**FIGURE 1:**  
**Percentage Decline in Active Correspondents by Region, 2011-2020**



This de-risking has especially disadvantaged smaller banks. Large financial institutions have withdrawn or declined correspondent bank relationships with smaller regional banks, a development evident in correspondent banking between U.S. and Mexican banks. Smaller banks also are disadvantaged by the high costs of complying with AML/CFT regulation and dealing

with its regulators, costs borne more easily by large international institutions. For example, JP Morgan Chase employs 9,000 people on AML/CFT matters, and Western Union spends \$200 million annually monitoring suspicious activity.<sup>30</sup> High compliance costs have forced many smaller financial entities to curtail or end providing services such as trade finance, business



payments to foreign suppliers abroad, and family remittance transactions. Accordingly, correspondent banking relationships involving local and regional Mexican banks declined 34 percent; and by 2016, only 23 of 53 Mexican banks surveyed maintained correspondent banking operations.<sup>31</sup> As a result, the U.S.-Mexican banking sector in this area has consolidated around a limited number of institutions; and compared to other Latin American economies of similar size, access to cross-border payments has been disproportionately restricted in Mexico.<sup>32</sup>

Correspondent banking relationships also declined worldwide from 2011 to 2020 with the largest declines in active correspondents affecting the smaller economies in Latin America, Africa, Southern Asia, and the Pacific. This decline was less severe in Mexico than in some other Latin American and Caribbean countries; but the value of correspondent banking transactions involving Mexico fell 8.2 percent while increasing substantially in 18 other Latin American countries, including other large nations in the region such as Brazil, Argentina, Chile, and Panama. The only Latin American countries that experienced larger declines than Mexico in the value of those transactions were Venezuela, Cuba, Belize, Barbados, the Bahamas, and Bolivia.

As we will see, this de-risking proceeded despite major reforms by the Mexican government to

address AML/CFT concerns, including changes in Mexican law to conform to standards put in place by the international Financial Action Task Force, revisions in bank secrecy requirements to provide more transparency around AML/CFT, improvements in monitoring banking transactions, and allowing domestic banks to share client information with international correspondent banks registered with the Ministry of Finance.<sup>33</sup> Since Mexican banks use correspondent relationships to transfer bulk dollars back to the United States, and cash poses a larger threat of being associated with money laundering, Mexico also established strict limits on domestic banking operations involving foreign cash and reporting requirements for cross-border transfers of bulk cash and procedures for foreign authorities to validate the reports.<sup>34</sup>

The Mexican government and financial institutions also established new databases to monitor cross-border financial transactions through domestic banks, including the customer, beneficiary, recipient bank, and amount sent for every financial transaction crossing Mexico's borders.<sup>35</sup> Mexican authorities also put in place a KYC utility to record the identity of users and clients involved in cross-border and domestic wire-transfers. Further, Mexico developed new mechanisms to offset in part the declining availability of U.S. correspondent banks, such as an interbank settlement system created by its central bank that uses U.S. dollars for local



interbank transfers.<sup>36</sup> By 2017, the IMF reported that Mexico had established a “mature AML/CFT regime, with a correspondingly well-developed legal and institutional framework.”<sup>37</sup>

Despite Mexico’s anti-money laundering reforms and compliance systems, the decline in correspondent banking services continued. The cumulative value of correspondent banking payments in Mexico fell 15.1 percent from 2011

to 2016 and 8.2 percent from 2011 to 2020. Further, the number of foreign correspondents per domestic bank in Mexico declined 34 percent from 2011 to 2020, nearly three times than the average decline for similar-size economies.<sup>38</sup> Mexico’s cross-border financial services market remains disrupted and underserved, impairing cross-border payments in trade and foreign direct investment as well as remittances and financial inclusion.

**TABLE 1:  
Changes in Correspondent Banking in Mexico  
and the United States, 2011-2020**

	VOLUME	VALUE	CORRESPONDENT BANKING RELATIONSHIPS
Mexico	22.2%	- 8.2%	- 20.0%
U.S.	41.9%	59.7%	- 9.8%

### III. REGULATION OF MONEY LAUNDERING / TERRORIST FINANCING AND CORRESPONDENT BANKING

Money laundering of all types involves tactics and strategies to hide an underlying crime and spend the proceeds from those crimes or use those proceeds to facilitate new crimes such as terrorism or tax evasion. Therefore, money laundering necessarily involves hiding the origins of funds from law enforcement.<sup>39</sup> For decades, money laundering typically involved

criminals convincing banks to accept those proceeds while obscuring their illegal origins and actual ownership. Analysts often describe the process of money laundering process in three stages: 1) “Placement” or moving funds directly associated with criminal activity to an entity that handles them, notably banks; 2) “Layering” or disguising the trail from the funds to their



owners using surrogates and shell entities; and 3) “Integration” or ensuring that the funds are available to their criminal owners through seemingly legitimate sources using false invoicing, loans, and other financial operations or purchases of legal assets such as stock or real estate.<sup>40</sup>

As noted, a central tool of AML/CFT efforts is the Know Your Customer (KYC) requirements.<sup>41</sup> KYC regulations direct that all banks and other federally chartered financial institutions confirm the identity of anyone depositing funds, the owners of any business opening an account, the identities of the officers and directors of foreign companies opening an account, and the identity of people or entities transferring \$10,000 or more. Under those regulations, individuals must provide their names, addresses, tax ID numbers and birthdates and must confirm the information by providing notarized proof such as a driver’s license and/or a verified social security number. Under the Bank Secrecy Act of 2016, all federally-regulated banks and credit unions, mutual funds, brokers and dealers, and commodity brokers are also required to identify the “beneficial owners” of any new account—anyone with a 25 percent or more interest in the assets of in an account or a company opening an account,<sup>42</sup> although trusts are exempted from that requirement.<sup>43</sup>

As we will see, while reliance on KYC regulation has focused especially on correspondent banking, criminal and terrorist organizations have shifted their strategies for laundering funds, largely forsaking correspondent banking relationships and often avoiding banks entirely. As a result, extensive research shows that criminals now routinely evade efforts to slow money laundering through KYC regulation of banks’ correspondent banking relationships.

### *The Dimensions of Money Laundering*

One reason for the failure of current anti-money laundering strategies is the sheer volume of funds being laundered. Estimates of the extent of money laundering, most of it through sham entities and non-banking channels, have ranged from \$600 billion to more than \$3 trillion per year, with most experts at the upper-end.<sup>44</sup> The World Bank estimates that between 2.0 percent and 5.0 percent of global GDP is laundered annually, which suggests a range of \$3.3 trillion to \$6.2 trillion in 2021.<sup>45</sup> The United Nations is more conservative, calculating that laundered funds worldwide totaled \$800 billion to \$2 trillion in 2021.<sup>46</sup> Efforts to detect money laundering through banking institutions also face the daunting volume of deposits and bank accounts: In 2021, weekly deposits in some 600 million accounts held in U.S. commercial banks averaged \$17.2 trillion.<sup>47</sup>



There is no central entity that collects and analyzes information about possible money laundering and then organizes and coordinates responses. In the United States, responsibilities for detecting laundered funds and enforcing anti-money laundering laws are divided among at least nine national agencies—in addition to the Financial Crimes Enforcement Network (FinCEN) and the Office of the Comptroller of the Currency (OCC) in the Treasury Department, the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve, the Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), the National Credit Union Administration (NCUA) and the Federal Bureau of Investigation (FBI) also are involved, as well as hundreds of state and local bank regulators and law enforcement agencies.<sup>48</sup>

Since most money laundering requires cross-border transfers, hundreds of agencies in other advanced and developing countries also collect information and try to enforce anti-money laundering laws. The multilateral organizations focused on money laundering, notably the Financial Action Task Force (FATF) and the Global Organization of Parliamentarians Against Corruption (GOPAC), have created standards for anti-money laundering legislation and practices. They also advise governments and other multilateral institutions that similarly monitor the problem, such as the World

Bank, the International Monetary Fund (IMF), the U.N. Office on Drugs and Crime (UNODC), Interpol, the Egmont Group, and Transparency International. However, coordination across countries remains difficult. While estimates of the volume of laundered funds are imprecise, experts believe that anti-money laundering operations detect in some way less than 10 percent of laundered funds worldwide and seize a fraction of one percent of all laundered funds.<sup>49</sup>

### *Weaknesses in Current Approaches*

Criminals have no difficulty acquiring fake driver's licenses and social security numbers to establish identification or in securing incorporation and licensing papers for sham, shell companies. When criminal organizations successfully use banks to launder funds, they also have routinely used proxies to establish the accounts and deposit, transfer, and receive the criminal proceeds. Those proxies may appear to be reputable. In recent years, attorneys, clergy, real estate agents and investors, as well as personnel from banks such as Lloyds Bank and the Bank of New York, have been convicted for depositing or receiving funds on behalf of criminal organizations through sham bank accounts and shell companies.<sup>50</sup>

Over the last decade, the internet also has become a prominent new source of false identities acquired through data breaches and used to create fake profiles that open accounts



and, as needed, launder funds by initiating and receiving transfers from shell companies, trusts and foundations or by purchasing and selling worthless equity in sham entities.<sup>51</sup> Sophisticated criminal organizations regularly create elaborate networks of those shell entities across many national jurisdictions to deposit, transfer and receive funds that become virtually untraceable. The Panama and Pandora Papers revealed tens of thousands of such shell companies established across the world to separate particular individuals or entities from the ownership of assets and thereby obscure the origins of very large amounts of money. On behalf of a Columbian drug cartel, for example, law firms and other financial services providers established more than 100 sham bank accounts in 68 countries that routed funds from the cartel through a series of European, Latin American and U.S. shell entities.<sup>52</sup>

To fulfill KYC requirements, these sham entities also often employ “nominee” directors and officers with no actual connection to the business or operations of the shell company, trust, or foundation. The financial services firms that create, incorporate, register, and license shell entities in places that require little documentation of ownership and protect the identities of clients—such as Panama, Hong Kong, and the Cayman Islands—often provide the nominee directors and officers that can authorize deposits, transfers, and receipts of funds from

illegal activities. A study of companies providing these services found that more than one-third required no documentation of an owner’s identity, including firms located in the United States, the United Kingdom, Spain, and Canada, and that some of them also set up bank accounts for the sham entities.<sup>53</sup> Similarly, in cases of tax evasion, nominee directors and officers can deposit, transfer, and receive funds that an owner wishes to hide from tax authorities. A survey of British financial institutions subject to KYC requirements under FATF agreements found that nearly two-thirds of bankers questioned their adequacy for AML/CFT purposes.<sup>54</sup>

Money launderers also can use one shell entity to pay another for “advice” and then repatriate the money through sham loans or consultancy work.<sup>55</sup> The officers and directors of these entities can authorize and secure issues of “bearer shares” so their assets can be claimed without identification.<sup>56</sup> Sophisticated money laundering operations also may use complex financial derivatives such as swaps involving OTC stocks carried out through an offshore company controlled by a money launderer, an approach also used by some multinational companies to shift profits from high-tax to low-tax countries.<sup>57</sup> Such financial maneuverings are carried out by professionals and established financial institutions, and the transactions are too complex for anyone but a small group of financial professionals to understand. As one expert in money



laundering noted, "...launderers abuse a variety of financial products of different complexity, with the largest amounts being laundered through the more complex products as part of schemes that are much more difficult to detect."<sup>58</sup> As AML/CFT regulation and the associated reforms put in place by Mexican financial institutions have hindered the ability of criminals to exploit traditional banking channels, money laundering has largely migrated to other channels and mechanisms, including cryptocurrencies, non-banking internet transactions, the use of complex financial instruments and sham entities, and informal non-banking channels.

Following the financial crisis of 2008-2009, efforts increased to reduce some obvious weaknesses in AML/CFT enforcement, especially regarding jurisdictions that protect bank secrecy without particular regard to the identity of depositors or beneficial owners of accounts. The G20 urged those bank and tax havens to agree to treaties requiring information exchanges and threatened economic sanctions if they declined. The major bank and tax havens agreed to sign more than 300 such treaties, but with limited effect.<sup>59</sup> Since many haven countries did not sign treaties with every other country, funds shifted to places that remained outside the treaties. And even when treaties are in place, experts have found that actual exchanges of information have remained fairly rare.<sup>60</sup>

Diligent and intensive investigation by banks have uncovered some subterfuges. In most cases, however, laundered funds are only discovered when a government has indicted a criminal and investigators have traced payments to or by the criminal through a bank. Over the last decade, this approach has resulted in large fines for financial institutions that allegedly facilitated the laundering of substantial sums, including ABN-Amro, Barclays, Credit Suisse, Deutsche Bank, HSBC, ING, Lloyds, Wachovia, American Express, and the Vatican bank.<sup>61</sup> By one estimate, banks and other financial institutions were fined \$4 billion for KYC violations in 2021.<sup>62</sup>

### *De-risking*

These dynamics also have resulted in banks undertaking a singular form of de-risking focused on their correspondent banking relationships. Again, since correspondent banking has been a principal way to transfer funds across borders in commerce and finance for more than a century, AML/CTF regulation and enforcement targeted correspondent banking arrangements principally through KYC requirements. However, those requirements have become very difficult to meet in ways that ensure that criminals do not use a bank to launder funds. As a result, banks holding accounts linked to people arrested for other crimes have been subject to large fines and the reputational damage from being publicly associated with high-profile criminals.



Beyond those costs, banking institutions also are subject to a wide array of other detailed regulations enforced by the same or related agencies responsible for AML/CFT oversight.

Yet, even as criminals adopted stratagems undetectable through KYC regulation or migrated to non-banking channels, AML/CFT regulation has continued to focus substantially on correspondent banking relationships. The economic logic for many banks became clear: Reduce the risks of incurring large fines and reputational damage for violations that they could not detect and attracting the attention of regulators in other areas by cutting back on their correspondent banking operations.

### *The Role of Shadow Banking*

In addition to the extensive use of false identities and networks of sham entities, money launderers also increasingly elude AML/CFT regulation and enforcement by using “shadow banking” arrangements that do not involve the initial placements of cash in banks. Internet and mobile payment services, electronic transfers on the internet, web peer-to-peer lending services, and prepaid cards all do not require bank accounts, accept virtual as well as regular currency, and generally are not covered by anti-money laundering regulation.<sup>63</sup> Criminals organizations also have been known to use internet-based equity crowdfunding to make payments without public reporting. While new

money laundering regulation now formally covers this approach, serial crowdfunding for sham projects operates in much the same way and remains outside the regulations.<sup>64</sup> All of these forms of transfers leave electronic trails, but their enormous volume makes it hard for law enforcement to identify those used by criminals. Anti-money laundering enforcement directed to banks and their correspondent banking operations are also useless when criminal organizations access informal banking arrangements that transfer funds through human intermediaries outside the banking system.<sup>65</sup>

Blockchain technologies that ensure anonymity also have been adapted for money laundering as well as remittances. For example, mobile phone-based blockchain platforms such as Clorins.ph with more than 300 million customers in Southeast Asia have been established recently to expedite transfers outside formal banks.<sup>66</sup> While Clorins.ph is formally regulated by the Philippine government, its blockchain provides peer-to-peer transfers through digital keys that entail no personal identification information.

Cash real estate purchases to move illegal funds to legitimate channels also fall outside the purview of most money laundering regulation. The Patriot Act initially covered real estate agents, brokers, developers, lawyers, and accountants involved in real estate sales, but the Treasury exempted the sector with narrow



exceptions:<sup>67</sup> Under current regulation, title insurance companies must identify the “beneficial owners” of cash real estate purchases for \$300,000 or more in nine U.S. counties, including those containing Los Angeles and San Francisco, Miami and Palm Beach, Honolulu, New York City, Boston, Dallas, and Chicago.<sup>68</sup> However, sophisticated criminals buying and selling real estate for cash can get around those identification requirements by using tiers of foreign-based shell companies and/or funds held by law firms in “pooled accounts” whose owners are protected by lawyer-client privilege.<sup>69</sup> Evidence suggests that real estate now plays a distinct role in money laundering: Some 62 percent of real estate purchases by foreign entities or individuals in the mid-2010s were cash transactions,<sup>70</sup> and FinCEN reports that 30 percent of real estate transactions in which beneficial owners paid or received cash were later identified as “suspicious.”<sup>71</sup>

### **Terrorist Financing**

Terrorist-related funds account for a small share of money laundering—by one estimate, Al Qaeda subsisted on \$30 million to \$50 million per-year before Osama BinLaden’s capture and death.<sup>72</sup> However, the Panama Papers and Paradise Papers documented the extent to which terrorist financing depends on networks of anonymous shell companies created in offshore financial centers and tax havens to hide and move their illicit funds.<sup>73</sup> Along with other

criminal organizations and tax evaders, terrorist networks also use sham charities, sham trusts and sham foundations as well as shell corporations, located usually in countries with weak anti-money laundering laws or enforcement.

Terrorist groups also are prominent users of “Informal Value Transfer Systems” outside the traditional banking system to shift funds anonymously through networks of intermediaries. These non-bank or shadow bank networks use a range of approaches and entities, including currency exchanges, stock brokerage accounts, casinos, auto dealerships, insurance trading companies, gems and precious metals, internet banking, and wire transfers.<sup>74</sup> Terrorist organizations and other money launderers in the Middle East have favored “hawala” arrangements also used by millions of people who work abroad, earn money legally, and want to send funds home at low costs.<sup>75</sup> Hawala is a type of shadow or underground banking that operates openly and provides a way to transfer funds based on personal trust between Hawala dealers rather than the guarantees of entities regulated by governments.<sup>76</sup> A person using hawala to transfer money from Dubai to a person in Karachi—for legitimate purposes or to launder the funds—gives cash to a dealer in Dubai, who gives the payor a code and communicates the amount and recipient’s name to a trusted dealer in Karachi who pays the designated recipient when he provides the code for verification.



Hawala transfers can occur without the payer or recipient providing any formal identification, and hawala dealers have no records of those payers and recipients. In some cases, two hawala dealers also may be partners in a legitimate business such as an import-export company and use the funds to clear debts between themselves by under-invoicing or over-invoicing for a recent or subsequent shipment.

“White” hawala, used for legitimate remittances, is less expensive and quicker than bank wire transfers, and several such informal transfer networks are also located in Asia, including Fei ch’ien in China, Phoe Khan in Thailand,

and Door-to-Door in the Philippines.<sup>77</sup> “Black” hawala involves illegal funds transferred by terrorist and other criminal organizations, often involving a series of dealers across several countries and sometimes entailing payouts in gold or investing the transferred funds in legitimate businesses to complete the money laundering process.

Based on these and other developments described earlier, the role of banks in terrorist financing and other money laundering, and the particular role of correspondent banking relationships, have diminished greatly.

#### IV. MEXICO AS A FOCUS OF U.S. AND INTERNATIONAL AML/CFT EFFORTS

Among the billions of financial transfers and payments between Mexico and the United States, some certainly involve funds being laundered. However, the likelihood of criminal organizations doing so by using correspondent banking between the two countries has become very small. As noted above, money laundering and terrorist financing have substantially migrated to non-banking channels including cryptocurrency exchanges, real estate transactions, and money transfer arrangements outside banking systems, as well as transfers through multi-tier networks of shell companies, trusts and foundations that do not involve correspondent

relationships. The *Financial Times* has noted, “the crackdown on money laundering has not necessarily curtailed the practice, but instead may simply have pushed it further underground.”<sup>78</sup> In addition, as IMF analysts reported in 2016, the burdens of the intense regulatory pressures on correspondent banks and possible sanctions have exerted significant pressure on correspondent banking relationships in Mexico, forcing many banks out of the legitimate operations of correspondent banking.<sup>79</sup>

The Mexican government and banking institutions also have taken aggressive measures to



sharply reduce the risk of criminal and terrorist organizations using the nation’s banks and accessing correspondent banking. In 2018, the IMF assessed these efforts in Mexico and concluded that “Mexico has a mature AML/CFT regime, with a correspondingly well-developed legal and institutional framework.”<sup>80</sup> The IMF noted that Mexico has increased its AML/CFT controls by implementing monitoring systems for real time gross settlement payments system, enforcing regulations requiring banks to use Legal Entity identifier standards, and adopting cross-border information sharing between domestic banks

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and foreign correspondent banks. Mexico also created and maintains a centralized database to share information and identify customers in cross-border transfers.<sup>81</sup> Given the enhanced concerns around transfers of bulk cash and the use of correspondent relationships to transfers bulk dollars from Mexican to U.S. banks, Mexico also imposed strict customer limits on deposits and transfers involving foreign cash and strict reporting of cash transferred from Mexican

to U.S. correspondent banks, with procedures for U.S. authorities to validate the reporting.<sup>82</sup> The World Bank has documented that Mexico also maintains and updates daily a database of domestic wire transfers in foreign currencies, cross-border transfers originating in Mexico, and transfers originating abroad, including KYC information about an ordering customer, recipient bank, beneficiary of the transfer, amount sent, and currency used.<sup>83</sup>

The IMF also has attested that the Mexican government revised the nation’s bank secrecy laws to support enforcement of AML/CFT regulation, and the Central Banco de Mexico has put in place a U.S. dollar credit transfer payment system for processing transfers in U.S. dollar accounts between domestic banks and Mexican firms that includes AML/CFT controls for firms and banks participating in the payment system.<sup>84</sup> The IMF’s main criticisms of the AML/CFT efforts

by Mexico involve “Designated Non-Financial Businesses and Professions” (DNFBP)—non-banking institutions using arrangements unrelated to correspondent banking.<sup>85</sup>

The Basel Institute on Governance (BIG) also monitors and evaluates how well 110 countries police their cross-border transfers and ranks them in the “Basel AML Index” for their efforts to discourage and discover laundered funds.<sup>86</sup>



The Basel Index covers both direct and indirect factors involved in money laundering and provisions to deter and punish it. The most important assessments cover each nation's compliance with 40 FATF recommendations and 11 FATF goals and the ability of AML/CFT enforcement to penetrate bank secrecy. Each country's ranking also draws on evaluations by the U.S. State Department of each country's effectiveness in tackling international drug and human trafficking and the World Bank's evaluations of each country's financial regulation and assessments of government and corporate transparency, public corruption and bribery, and the strength of the rule of law and political liberties. The 2021 Basel Index found that Mexico's efforts to prevent money laundering and terrorist financing were superior to those in 60 other countries, ranging from Cayman Islands, Thailand, and the Philippines to Russia, Saudi Arabia, and Hong Kong.

Consistent with our analysis of the inefficiency of focusing anti-AML/CTF enforcement on KYC regulation of correspondent banking relationships, the BIG 2021 analysis also highlights the growing use by money launderers and terrorist groups of non-banking strategies, the ineffectiveness of technical compliance with AML/CFT regulation, inadequate monitoring of beneficial ownership, and weak application of AML/CFT measures to non-financial entities. The 2021 Index report notes, as a "simple example,"

*... money launderers can buy and sell properties or precious metals to help obscure the illicit origins of their money ... use corporate vehicles to disguise the true ownership and control of the funds and assets... (while) lawyers, accountants and TCSPs [trust and company service providers] are advising and assisting criminal clients with hiding and laundering illicit funds.<sup>87</sup>*

An important factor in Mexico's strong AML/CFT performance is the transparency of its banking transactions to AML/CFT enforcement, given that the secrecy of financial transactions is a basic element of money laundering and terrorist financing. In addition to the BIG rankings, the Tax Justice Network (TJN) conducts intensive analysis of secrecy and cross-border financial transactions covering 133 countries, including legal provisions for secrecy in banking transactions and administration. TJN publishes the results in its Financial Secrecy Index (FSI).<sup>88</sup> The most recent FSI findings show that financial secrecy in Mexican banking—including correspondent banking—does not significantly inhibit AML/CFT efforts in Mexico.

The FSI applies 20 standards or benchmarks to generate a "secrecy score" for each country based on how much financial secrecy it provides under its laws, regulations, and treaties.<sup>89</sup> Those benchmarks include evaluations of each country's bank secrecy laws, provisions



to register and monitor both local and foreign trusts and foundations, provisions to establish the legal and beneficial owners of companies, including limited partnerships, and the public access to such information. The standards also cover whether companies are required to publish country-by-country financial reports and whether a country bars bearer shares. Finally, a country's secrecy score also depends on the extent to which a country follows the anti-money laundering recommendations of the FATF, participates in exchanges of financial information with other countries, adopts bilateral treaties for information exchanges with at least 108 other countries, and cooperates with international agencies to detect money laundering.

TJN reported that based on those scores, Mexico is more transparent than 109 of the 133 countries and well ahead of countries such as the United States, Japan, Canada, and Israel.<sup>90</sup>

The FSI also analyzes global data on capital flows to evaluate the extent of each country's participation in worldwide cross-border flows of funds through its financial institutions. These findings are an important measure for allocating AML/CFT resources where they are likely to be most productive. Those data show that Mexico's banks provided less than one-tenth of one percent (0.09 percent) of all such international financial transfers and payment services, for criminal as well as legitimate purposes.<sup>91</sup>

All told, 47 other countries handle larger shares of those cross-border financial transactions, including 11 major players. In five countries (Ireland, Hong Kong, Switzerland, France, and Japan), financial institutions handle between 25 and 50 times as many transactions as their Mexican counterparts; and in three more countries (Singapore, the Cayman Islands and Germany) such institutions handle between 50 and 100 times as many transactions as those in Mexico. Three additional nations (Luxembourg, the United Kingdom, and the United States) are the dominant players in these international financial flows, processing nearly half of all worldwide cross-border transactions and accounting respectively for 137 times, 177 times, and 237 times as many of those transactions as Mexico's financial institutions.

Moreover, seven of the 11 major players in cross-border financial flows—Hong Kong, Switzerland, Singapore, the Cayman Islands, Luxembourg, Japan, and the United States—also are less transparent to AML/CFT regulatory efforts than Mexico. This clearly suggests that targeting AML/CFT regulation and enforcement on financial flows between the United States and those less-transparent and more important players in cross-border transactions would be much more efficient than the focusing on U.S.-Mexico transactions involving correspondent banking.



## V. ECONOMIC EFFECTS OF DE-RISKING IN CORRESPONDENT BANKING

### *Foreign Direct Investment*

Among the millions of payments and transfers flowing between the United States and Mexico, foreign direct investments (FDI) have the most far-reaching economic effects. FDI from the United States to Mexico is the principal means of introducing advanced technologies and business operations and as a result plays a critical role in Mexico’s continuing economic development.<sup>92</sup> FDI also flows from Mexico to the United States, where it can provide technical and marketing knowhow valuable to consumers of Mexican products in the United States. These FDI transfers can involve joint ventures with local Mexican or U.S. companies or the establishment of new foreign affiliates or subsidiaries in Mexico or the United States. FDI involves transfers of advanced management skills and operational knowledge as well as technologies and marketing expertise, which local Mexican and American companies can emulate and replicate. FDI-based enterprises also can stimulate new business creation and expanded operations by existing firms to provide local goods and services for the new enterprises. These features of FDI transfers also generate local income that in turn supports jobs, growth, and government revenues.

The stock of Mexican FDI in the United States totaled \$20.85 billion in 2020 (\$40.1 billion by “Ultimate Beneficial Owner”), including \$5.3 billion in manufacturing and \$4.0 billion in agriculture and food.<sup>93</sup> (“Ultimate Beneficial Owner” here refers to FDI that may enter the United States from any country but is owned by Mexican person or entity, as for example, FDI by a European LLC controlled by a Mexican national or multinational company.) FDI flows from Mexico to the United States from 2016 to 2020 totaled \$8.0 billion including \$1.85 billion in 2020 and averaging \$1.6 billion per-year.<sup>94</sup> Similarly, U.S. companies made \$3.1 billion in foreign direct investments in Mexico in 2020, and the stock of U.S. FDI in Mexico totaled \$101.1 billion, including \$11.2 billion in energy and mining and \$40.9 billion in manufacturing.<sup>95</sup>

The data do not track the share of those FDI transfers flowing through formal correspondent banking relationships. However, it is reasonable to assume that a majority of those transfers have involved correspondent banking operations: Banking institutions handle all FDI funding between the United States and Mexico as well as repatriated profits from a consequent joint ventures, affiliates, or subsidiaries;



and FDI involves long-term commitments that entail additional capital transfers by companies with ongoing business with local and foreign banking institutions.

We also should expect that the misplaced oversight of correspondent banking arising from AML/CFT efforts has affected FDI-related flows between the United States and Mexico. Studies show that multinational corporations considering FDI place considerable importance on regulatory constraints and costs,<sup>96</sup> and the contraction in correspondent banking activities between the United States and Mexico constrain or increase costs for companies transferring assets across borders and accessing income earned abroad. In addition, analysts have found that uncertainty adversely affects FDI flows, and the current oversight of correspondent banking between the two countries may create new uncertainties about the timing and availability of those transfers.<sup>97</sup>

Therefore, we should expect that the contraction in correspondent banking operations affected FDI. In the extreme case of Belize, 83 percent of its correspondent banking relationships ended from 2013 to 2016, and the IMF

estimated that the worst case result of those changing conditions could dampen FDI flows equivalent to two-to-three percentage points of the country's GDP.<sup>98</sup> Moreover, studies have found that reductions in FDI can dampen growth, GDP and employment by reducing private capital flows, slowing the adoption of new technologies and productivity gains associated with FDI, and easing competitive pressures.<sup>99</sup> Analysts have found that changes in FDI also can have significant effects on a country's productivity, wages, and employment.<sup>100</sup>

The United States is not immune from those effects, given that Mexican FDI in the United States supported 82,600 jobs in 2020 and the stringent AML/CFT regulation of correspondent banking is expected to affect those FDI flows.<sup>101</sup> To estimate the impact of the contraction in correspondent banking relationships on FDI in this case, we used a "difference-in-differences" econometric approach comparing Mexico to countries in Latin America with below-median reductions in correspondent banking values (controlling for other relevant variables) and extrapolated the effects on FDI from Mexico to the United States. We also estimated the associated secondary effects on U.S. capital stock, GDP,

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**Mexican FDI flows to the United States were reduced by an estimated 0.31 percent or \$477 million per-year, resulting in an estimated \$3.3 billion reduction in the stock of Mexican FDI in the United States compared to its expected levels without the shift in correspondent banking operations.**



and employment associated with the changes in correspondent banking.<sup>102</sup>

This modeling suggests that compared to countries with smaller shifts in correspondent banking relationships, the changes in those operations in Mexico and the United States were associated with slowdowns in FDI flows and stocks from 2012 to 2018. The analysis found that Mexican FDI flows to the United States were reduced by an estimated 0.31 percent or \$477 million per-year, resulting in an estimated \$3.3 billion reduction in the stock of Mexican FDI in the United States compared to its expected levels without the shift in correspondent banking operations. FDI associated with a country's companies or individuals also can enter another country through entities in third countries. Using the measure that includes these "Ultimate Beneficial Owners" (UBO), the relative reduction in FDI into the United States and linked to Mexico totals \$15.7 billion over the seven-year period.

The UBO analysis suggests that this slowdown in FDI to and in the United States reduced the American economy's capital stock by an average of 0.02 percent per-year from 2012 to 2018, which in turn slowed

both GDP growth and job gains by an average of 0.03 percent per-year. As a result, the impact of AML/CFT regulation of correspondent banking on FDI from Mexico to the United States was associated with slowing GDP growth by about \$56 billion per-year and slowing employment gains by an estimated 40,728 jobs in a given year from 2012 to 2018.

### Trade

The importance of international trade flows to promote growth has been broadly accepted by economists for more than two centuries. Every nation has distinctive advantages and disadvantages as compared to others, and an economy is most efficient when its production draws on its relative advantages and the country relies on other economies for other goods and services. As a result, trade provides access to good

and services from the most efficient sources and thereby provides lower prices and greater choice.<sup>103</sup> While trade is one of many factors associated with growth and its factors, analysts also have found that national income and productivity both tend to grow faster in countries with relatively larger trade sectors.<sup>104</sup> With regard to trade and employment, lower-price imports can

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CFT regulation of correspondent  
banking on FDI from Mexico to the  
United States was associated with  
slowing GDP  
growth by about  
\$56 billion/year  
and slowing employment gains  
by an estimated 40,728 jobs in a  
given year from 2012 to 2018.**



result in job losses over a short-term by firms unable to compete.<sup>105</sup> Over a longer-term, the direct and indirect benefits of trade are associated closely with both higher employment overall<sup>106</sup> and with job losses in some industries competing directly with imports.<sup>107</sup>

The withdrawal of correspondent banking has increased the barriers to trade for the countries most effected, both by adding to the cost of cross-border transactions and by creating difficulty in accessing trade finance. One study found that banking authorities listed trade finance as the service or product affected most by the decline in correspondent banking relationships.<sup>108</sup> Moreover, the U.S.-Mexico trade relationship is enormous. In 2019, the United States exported \$289.4 billion in goods and service to Mexico, including \$96.5 billion in industrial supplies and materials and \$83.9 billion in capital goods.<sup>109</sup> U.S. imports from Mexico in 2019 were even greater, totaling \$393.1 billion including \$136.2 billion in auto vehicles, parts, and engines and \$106.3 billion in other capital goods.<sup>110</sup> These 2019 trade flows were equivalent to 3.3 percent of U.S. GDP and a remarkable 56.0 percent of Mexico's GDP.<sup>111</sup> According to a study from the Wilson Center, nearly 5,000,000 American jobs were related to U.S. trade with Mexico in 2016.<sup>112</sup>

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**The reduction in Mexican exports associated with the heightened regulatory burdens on correspondent banking was associated with a slowdown in job gains totaling**

**113,830 jobs over the ten-year period.**

To estimate the impact of AML/CFT regulation of correspondent banking on trade between the two countries, we applied an econometric approach similar to the one described above for FDI: We surveyed the export and import data for Latin American countries from 2000

to 2021 and employed a series of “difference-in-differences” estimations to model how U.S.-Mexico trade fared relative to neighboring countries with below-median reductions in correspondent banking relationships, controlling for relevant variables. The results were statistically significant for exports and showed that the impact of AML/CFT regulation on corre-

spondent banking between the United States and Mexico was associated with a \$74.3 billion reduction in U.S. imports from Mexico from 2011 to 2021 or about 2.0 percent.

This impact had consequences for U.S. employment. Based on a model of the effects of trade shocks developed by the Wilson Center and Trade Partnership,<sup>113</sup> the reduction in Mexican exports associated with the heightened regulatory burdens on correspondent banking was associated with a slowdown in job gains totaling 113,830 jobs over the ten-year period.



## Remittances

In 2021, households in Mexico received \$51.6 billion in personal remittances from abroad, of 95 percent of which originated in the United States. These remittances represented 4.0 percent of Mexico's GDP or more than five times the world-wide average,<sup>114</sup> and the largest recipient of remittances in Latin America.<sup>115</sup> (See Figures 2-A and 2-B below.) The flow of these remittances to Mexico declined during the financial crisis and rebounded with the recovery of the U.S. labor market.<sup>116</sup> The average cost to send remittances to Mexico fell as the flows increased, declining

22 percent from 2012 to 2015 as the value of those flows rose 12 percent.<sup>117</sup> However, while bank de-risking of correspondent banking activities has not slowed the volume of these remittances, it has reduced access to banking for lower-income Mexican families.

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**...while bank de-risking of correspondent banking activities has not slowed the volume of these remittances, it has reduced access to banking for lower-income Mexican families.**

**FIGURE 2-A:  
Personal Remittances as a Share of GDP: Mexico,  
Latin America, and the World<sup>118</sup>**

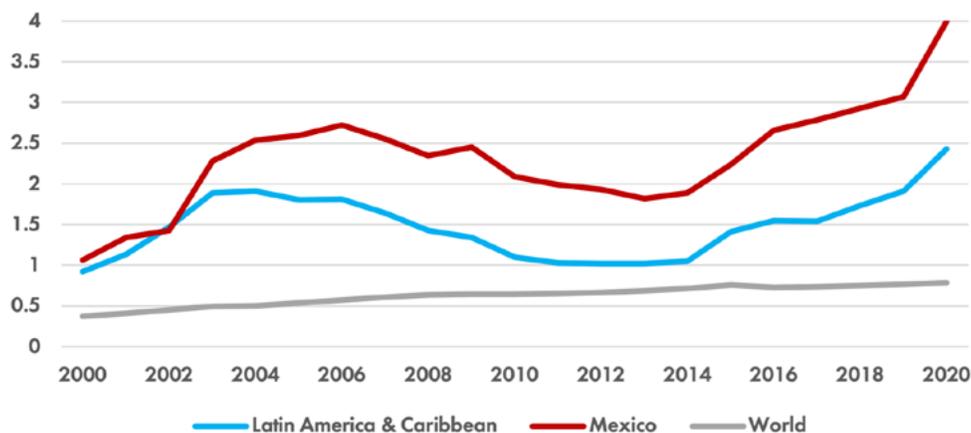


FIGURE 2-B:

**Share of Mexican Remittances from the United States  
(Four-Quarter Moving Average)**

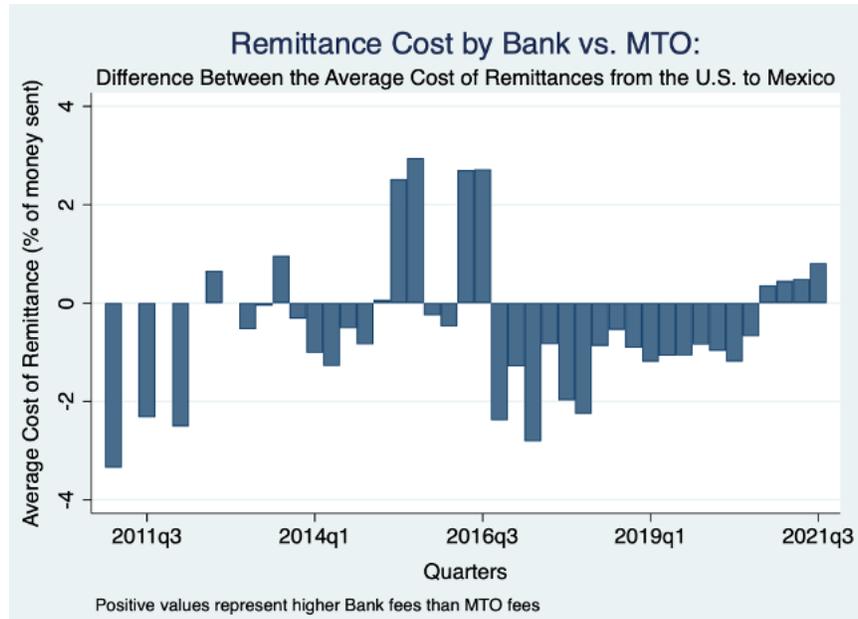


The impact of AML/CFT regulations and enforcement scrutiny on remittance transfers has particularly burdened money transfer operators (MTOs) that depend on correspondent banks. In 2013, following the ramp-up in regulatory scrutiny of correspondent banking relationships, nearly 80 percent of surveyed MTOs reported difficulties opening correspondent banking accounts,<sup>119</sup> and 60 percent of local banks in Latin America reported difficulties supporting remittances in 2015.<sup>120</sup> As the costs associated with AML/CFT regulation increased, the competitive and transparent Mexican remittance market became concentrated in fewer banks and MTOs, creating barriers for new competitors and shifting more consumers to informal or non-banking channels.

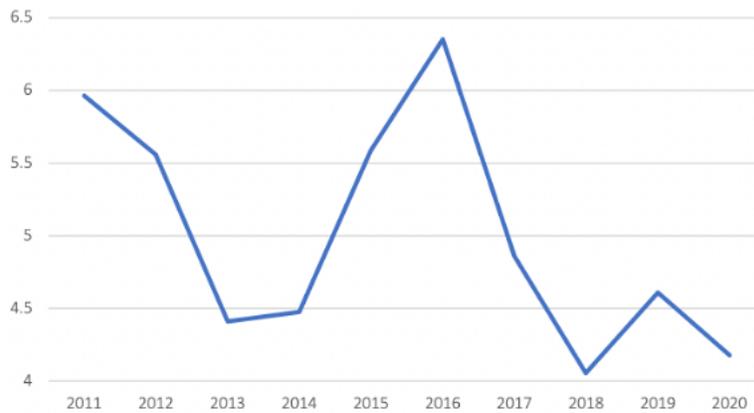
While nearly all remittances tracked by Mexico's central bank are conducted by electronic transfer, MTOs and other non-bank institutions handle more than 77 percent of tracked remittances<sup>121</sup> and typically involve higher fees than banks (Figure 3 below). The World Bank calculates that the current cost to transfer and receive a \$200 remittance from the United States to Mexico averages \$8.79.<sup>122</sup> While the official data show that transaction costs have fallen as a share of the value of the remittances (Figure 3-Bbelow), some experts maintain that a significant share of remittances involve cash not captured by the central bank data.<sup>123</sup>



**FIGURE 3-A:**  
**Cost of Remittance Transfers from the U.S. to Mexico, Banking versus MTOs**



**FIGURE 3-B:**  
**Average Transaction Cost of Remittances to Mexico as a Percentage of their Value**



As noted above, the withdrawal of many local and regional Mexican banks from remittance services associated with AML/CFT scrutiny has hindered efforts to expand financial inclusion among Mexican households. The World Bank reports that the share of Mexicans with bank accounts declined from 39.1 percent in 2014 to 36.9 percent in 2017, and among the 40 percent lowest-income households, that measure of financial inclusion fell from 29.4 percent to 25.8 percent.<sup>124</sup> By contrast,

across all non-high income Latin American and Caribbean countries in those years, the share with bank accounts grew from 41.4 percent to 54.4 percent, and among the 40 percent lowest-income households, that share increased from 40.7 percent to 41.9 percent.<sup>125</sup>

Finally, the adverse effects from the current scrutiny of correspondent banking also include higher costs for individuals and businesses that receive foreign paper currency and other foreign cash, because Mexican banks usually use their corresponding banking relationships to transfer bulk U.S. dollars to the United States.

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**The central bank estimates that \$6.3 billion in U.S. currency was transferred in bulk in 2021, half of it from tourism and the rest from payments to Mexican workers employed near the U.S.-Mexico border, “pocket remittances” carried back to Mexico by visiting migrants, and criminal proceeds seized by the Mexican government.**

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The large flows of remittances from the United States to Mexico enhance Mexican GDP and growth both directly and

indirectly by supporting education and by promoting investment and trade.<sup>127</sup> By contrast, remittances have much more modest economic effects in other Latin American countries, even those with sizable migration.<sup>128</sup> Finally, remittances to Mexico have beneficial distributional effects. Evidence from microdata show that lower-income Mexican households are far more likely to benefit from remittances, especially during recessionary periods: The average recipient household is in the fourth income decile, while the average household not receiving remittances is in the seventh income decline.<sup>129</sup>



## VI. CONCLUSIONS

The United States and Mexico are extensively interconnected economically through flows of foreign direct investment, trade, and remittances. In the past, money launderers used the cross-border payment channels for those investments, trade, and money transfers, including correspondent banking relationships and operations. Much of the U.S. effort to curtail money laundering and terrorist financing consequently focused on correspondent banking.

Developments over the past decade raise serious questions about this approach. Money launderers can often evade the principal tactic, Know Your Customer regulation, through false

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**Over the past decade, the Mexican government and banking institutions have established modern systems to track transactions and comply with AML/CFCT standards and protocols, and the IMF and World Bank have commended Mexico for these developments.**

identities and nominee officers and directors and, most important, by establishing extensive tiers of sham companies, trusts, foundations, and other entities distributed across many borders and jurisdictions. Money laundering and terrorist financing has also migrated to channels and entities outside bank regulation through internet-based exchanges, cryptocurrency

operations, and informal money transfer systems around the world.

In the case of Mexico, a continuing focus on correspondent banking relationships appears to be misplaced. Over the past decade, the Mexican government and banking institutions have established modern systems to track transactions and comply with AML/CFCT standards and protocols, and the IMF and World Bank have commended Mexico for these developments. Other international bodies also have found that Mexico has fulfilled most international AML/CFT requirements, including amending its bank secrecy rules to support and comply with

those efforts. International analysis also shows that Mexico presents a very small target for U.S. AML/CFT efforts as the country accounts for a very minimal share of global cross-border financial payments and transactions.

Despite these developments, U.S. AML-CFT efforts continue to focus significantly on Mexico and its correspondent banking relationships with U.S. banking institutions. As a result, many banks in both countries have moved to reduce their regulatory costs and risks by reducing correspondent banking activities involving Mexico. This de-risking has especially affected



smaller local and regional banks in Mexico. Moreover, econometric analysis shows that the reductions in cross-border correspondent banking relationships and values associated with AML/CFT efforts have resulted in slower growth in foreign direct investment and trade between the two countries than would have been expected, but for the AML/CFT focus on correspondent banking.

The analysis found that these AML/CFT efforts from 2012 to 2018 impaired FDI flows from Mexico to the United States by nearly \$480 million per-year and impaired the U.S. stock of FDI by \$3.3 billion and Mexico's stock of FDI by \$1.4 billion in any given year. Further, these effects dampened U.S. growth by an estimated \$5.5 billion per-year and slowed job growth by an average of nearly 41,000 jobs in any given year from 2012 to 2018. The decline in correspondent banking associated with the misplaced AML/CFT efforts also reduced Mexico's exports to the United States by nearly \$75 billion from 2011 to 2021, dampening U.S. employment gains over that period by nearly 114,000 jobs.

These AML/CFT efforts focused on correspondent banking did not reduce the flow of remittances from people residing in the United States to family and friends. However, they have substantially reduced the numbers of banks in the remittance business, which in turn has increased the burdens and cost of sending and receiving remitted funds. Finally, the people adversely affected in this way are generally those least able to bear those associated burdens and costs, including lower-income individuals and those with marginal access to financial institutions.

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**Finally, the people adversely affected in this way are generally those least able to bear those associated burdens and costs, including lower-income individuals and those with marginal access to financial institutions.**



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## ENDNOTES

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