

---

## Offshore US Dollar Clearing Systems: A Risk Businesses Can No Longer Afford

George F. Thomas, *Radix Consulting* - 13 Oct 2009

*This article discusses the risks inherent in offshore US dollar clearing systems and looks at how regulators can reduce or eliminate this risk.*

Countries that have implemented offshore US dollar clearing systems have introduced credit risk that should no longer be necessary or acceptable to regulators, banks and their business customers. The offshore US dollar clearing systems in Tokyo, Hong Kong, and the Philippines were established when there was no facility to settle Asian US dollar transactions during the Asian business day.

However, the implementation of the 20-hour processing day by Fedwire and CHIPS, which overlaps with the Asian business day, has eliminated the need for clearing US dollars offshore. The credit risks do not justify the benefits. CHIPS and Fedwire both have real-time payment settlement finality using central bank money, unlike the offshore systems that rely on a commercial settlement bank to maintain the US dollar accounts that are used in their real-time gross settlement (RTGS) schemes.

### Credit Risk

The global financial crisis that occurred over the past year should have made it clear to all financial system participants that many extremely large financial institutions were significantly stressed and many would have failed without support from their governments. While the governments stepped in during this crisis, there is no guarantee that they will do the same in a future crisis - and the concept of 'too big to fail' may finally vanish from our vocabulary.

So what does this mean to banks and their customers whose transactions are completed on offshore US dollar clearing systems? The answer is a huge credit risk exposure to those systems that rely on a commercial bank for settlement i.e commercial bank money versus central bank money. The credit risk exposure of the direct and indirect clearing participants to the settlement institution is real unless the central banking authority guarantees the intraday and overnight risk posed by these commercial entities. The risk is exacerbated for those banks that indirectly participate in these clearing arrangements because they have exposure to the settlement institution as well as to the bank that clears their transactions.

### Corporate Risk

Global treasury managers should be aware of how their payments are to be cleared. If they have business operations in these markets then it would be prudent for them to ensure that all US dollar-denominated payments are executed using the US-based CHIPS or Fedwire systems only. Clearing payments through the US systems will eliminate the credit risk exposure because payments are final using central bank money. There is no valid reason that your bank can offer for using the offshore clearing mechanisms.

### Office of Foreign Assets Control

To some banks, one of the unspoken benefits of using an offshore US dollar clearing system is the lack of scrutiny of these transactions for compliance with US Office of Foreign Assets Control (OFAC). Institutions that have a regulated presence in the US are still required by law to comply with OFAC regulations. Banks that do not have a regulated presence can clear US dollar payments offshore without putting controls in place for OFAC compliance. US regulators need to take steps to ensure that these offshore systems are not used to circumvent US government controls. The offshore clearing systems should not be a convenient tool for moving funds to accommodate terrorist financing and other illegal activities.

### Regulators

The Federal Reserve has done very little to control the risk generated by the multitude of payments systems being developed to clear and settle US dollar payments offshore. In fact, China has recently implemented an offshore clearing facility. The Fed has regulatory control over US and foreign banks that have banking licenses in the US and should exert regulatory control over these institutions, making them aware that these risks are no longer acceptable. The Fed, as part of the Treasury Department, also has a responsibility to ensure that these systems are not used to avoid US sanctions and compliance programmes.

The central banking authorities of these countries should not permit these risks to continue. The settlement institutions that have the responsibility for holding the US dollar accounts and settling for these offshore payments have no explicit backing or guarantee from the government authorities. If these offshore US dollar clearing operations are to continue, the settlement institution must be guaranteed by the central banking authority. An unwillingness to provide this guarantee makes it clear that the government authorities do not have an appetite for accepting these risks, so why should the banks and the banks' business customers be willing to accept this credit risk?

### Conclusion

The global financial crisis has made it abundantly clear that there is very little tolerance for the concept of 'too big to fail'. It is incumbent on the regulators of each country to ensure that banks are not undertaking unnecessary risk. It is the view of this author that offshore US dollar clearing systems create unacceptable risks that can no longer be tolerated, especially in light of the fact that they are no longer needed.

[Back to top](#)