



Observatoire ARGA

**DE-RISKING AND FINANCIAL FRAGMENTATION IN ASIA: A STRUCTURAL
ASSESSMENT OF RISKS FOR CROSS-BORDER TRADE, INVESTMENT FLOWS,
AND DEVELOPMENT RESILIENCE**

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Paris, 16 February 2026

Purpose of the Document:

To provide regulators and development institutions in Asia with an analytical framework for assessing the systemic risks of de-risking, its impact on regional integration, project finance, and the resilience of financial flows.

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1. EXECUTIVE SUMMARY

De-risking — the practice of terminating or restricting financial relationships due to elevated compliance or sanctions risk — is increasingly becoming a systemic factor affecting the resilience of Asia’s financial centers and regional economic integration.

In the context of global sanctions regimes, automated AML screening, and heightened regulatory scrutiny, banks seek to minimize potential exposure, often resulting in defensive compliance and the reduction of cross-border relationships.

For Asia, this dynamic has strategic implications:

- the reduction of correspondent banking relationships affects trade finance;
- transaction costs increase;
- access to international capital markets becomes more complex;
- development projects face unpredictable delays.

This report provides a structural assessment of the drivers of de-risking and proposes a risk mitigation model aimed at preserving regional resilience and competitiveness.

2. DE-RISKING AS A GLOBAL PHENOMENON AND ITS SPECIFICITY IN ASIA

2.1. Global Context

De-risking expanded significantly following the substantial broadening of sanctions regimes, the tightening of AML/CFT standards, and increased regulatory liability for banks in cases of insufficient customer and transaction due diligence. Large monetary penalties, extraterritorial sanctions, and personal liability for senior management have strengthened incentives to reduce regulatory exposure by terminating relationships with categories of clients perceived as “high risk.”

In several jurisdictions, de-risking has been driven less by proven violations and more by enforcement uncertainty, divergent interpretations of standards, and concerns over reputational damage.

2.2. Specific Features in Asia

Asian financial centers are characterized by a high degree of international integration and function as transit hubs for global financial flows.

They:

- are deeply engaged in cross-border trade and settlement activity;
- depend on the stability of correspondent banking networks;
- serve a broad spectrum of international clients, including corporations, funds, and private investors;
- provide financing for export-import operations and infrastructure projects.

Under such conditions, excessive de-risking can generate disproportionate macroeconomic effects, affecting not only individual companies but entire sectors.

2.3. Strategic Risk

When de-risking becomes a dominant risk-management strategy, it transforms from an instrument of individual bank protection into a driver of systemic fragmentation.

This may result in:

- reduced access to international settlement systems;
- disruptions in supply chains;
- increased operational costs for businesses;
- reallocation of financial flows into less regulated channels.

Over the long term, such dynamics may undermine regional integration and weaken the resilience of financial infrastructure.

3. SOURCES OF DE-RISKING

3.1. Sanctions Signals

Even indirect associations with sanctions-sensitive individuals or entities may serve as grounds for restricting or terminating relationships.

Risk intensifies in cases involving:

- secondary sanctions;
- ambiguity regarding the legal status of a person or entity;
- media amplification of reputational signals.

Banks frequently opt for full termination of relationships in order to minimize potential regulatory exposure.

3.2. AML Uncertainty

Divergent interpretations of FATF standards, national regulatory requirements, and supervisory practices create conditions in which banks adopt the most conservative possible approach.

Uncertainty may concern:

- criteria for enhanced risk classification;
- due diligence requirements;
- the depth of beneficial ownership verification;
- the admissibility of indirect or circumstantial evidence.

In an environment of legal ambiguity, institutions often prefer relationship termination over active risk management.

3.3. Automated Compliance Systems

Screening and risk-scoring algorithms amplify secondary signals, including adverse media references and indirect connections.

Automation:

- accelerates risk escalation;
- increases the volume of false-positive alerts;
- reduces the role of contextual assessment;
- raises the likelihood of automatic relationship termination.

Technological tools, while designed to enhance compliance efficiency, may unintentionally expand the scale and systemic impact of de-risking.

4. IMPACT ON CORRESPONDENT BANKING RELATIONSHIPS AND TRADE FINANCE

4.1. Correspondent Banks

The termination of correspondent banking relationships restricts access to international payment infrastructure, including settlements in US dollars and euros.

Such restrictions may:

- reduce the capacity of domestic banks to conduct international settlements;
- increase transaction costs due to the need for intermediary institutions;
- force banks to rely on alternative channels that are less efficient and more expensive;
- limit access to global clearing systems and liquidity pools.

In highly open Asian economies, the stability of correspondent networks is a foundational element of trade, investment, and financial intermediation. Systemic contraction of these networks may therefore have macro-financial implications.

4.2. Trade Finance

De-risking has a direct impact on export-import operations, particularly in emerging market economies where trade finance is heavily bank-dependent.

Potential consequences include:

- shipment delays caused by enhanced screening and additional documentation requirements;
- increased costs of letters of credit and bank guarantees;
- greater complexity in transaction structuring and compliance verification;
- restricted access to foreign currency financing.

These effects reduce business competitiveness, increase working capital requirements, and weaken the resilience of regional supply chains.

4.3. Small and Medium-Sized Enterprises

SMEs are particularly vulnerable to the contraction of banking services, as they often lack access to diversified funding sources.

For SMEs, de-risking may result in:

- loss of access to international markets;
- higher financing costs and collateral requirements;
- reduced investment activity and slower growth;
- diminished participation in regional value chains.

As SMEs form a substantial share of employment and economic activity in Asia, disproportionate de-risking may have broader socioeconomic consequences.

5. RISKS FOR INVESTMENT FLOWS AND CAPITAL MARKETS

5.1. Investors

Predictability of banking services and reliable access to payment infrastructure are key determinants of investment attractiveness.

Systemic de-risking may:

- increase the risk premium demanded by investors;
- reduce capital inflows;
- contribute to greater market volatility;
- weaken investor confidence in financial system stability.

Investment decisions increasingly incorporate operational banking risk as part of jurisdictional risk assessment.

5.2. Listing Venues

Excessive compliance uncertainty and instability in banking services may reduce the competitiveness of listing venues by complicating IPO processes and secondary offerings.

Issuers may face:

- extended due diligence procedures;
- heightened scrutiny of cross-border exposure;
- increased disclosure requirements related to banking and sanctions risks;
- valuation discounts due to perceived operational uncertainty.

Over time, such dynamics may shift listing activity toward jurisdictions perceived as more predictable.

5.3. Private Capital

Private capital and private equity funds may reallocate resources toward jurisdictions offering more stable compliance regimes and settlement infrastructure.

This reallocation may affect:

- regional capital formation;
- exit strategies and transaction structuring;

- long-term investment planning in emerging sectors.

6. IMPACT ON DEVELOPMENT PROJECTS AND INFRASTRUCTURE

6.1. Project Finance

De-risking may delay disbursements, block financing tranches, and increase funding costs for infrastructure projects.

Given the multi-year horizon and complex financial structures of such projects, even temporary restrictions may:

- disrupt construction timelines;
- increase refinancing risk;
- reduce project viability.

6.2. Public-Private Partnerships

Reduced predictability of banking participation weakens trust between public authorities and private investors.

Uncertainty in financial intermediation may:

- complicate risk allocation frameworks;
- increase contingency costs;
- deter long-term private sector participation.

6.3. Regional Initiatives

ASEAN integration projects and other regional development programs depend on stable financial channels and cross-border payment systems.

Financial fragmentation may:

- slow implementation of joint initiatives;
- raise coordination costs;
- undermine economic integration objectives.

7. REGIONAL INTEGRATION AND THE RISK OF FINANCIAL FRAGMENTATION

7.1. Fragmentation

Systematic avoidance of certain client categories may disrupt regional value chains and weaken economic interconnectedness.

Fragmentation manifests through:

- segmentation of payment systems;
- uneven access to correspondent networks;
- concentration of financial services in limited jurisdictions.

Such developments may reduce efficiency and increase systemic vulnerability.

7.2. Parallel Systems

Intensified restrictions may encourage the development of alternative, less transparent financial channels.

These parallel systems may:

- reduce the effectiveness of AML controls;
- increase opacity in cross-border transactions;
- elevate systemic and reputational risks.

Paradoxically, excessive de-risking may undermine the very compliance objectives it seeks to protect.

8. PROPORTIONALITY MODEL AND RISK MITIGATION FRAMEWORK

8.1. Principle of Proportionality

Risk assessment should consider:

- the legal status of the subject;
- the credibility and verification of the information source;
- the economic context and systemic relevance of the transaction;
- the existence of a judicial decision or formal sanctions basis.

Proportionality requires calibrated responses rather than categorical termination of relationships.

8.2. Risk Mitigation Framework

Recommended elements include:

- mandatory secondary review of politically sensitive signals;
- time-bound restrictive measures;
- periodic reassessment at fixed intervals;

– a remediation pathway allowing restoration of relationships once risks are mitigated.

Such mechanisms support balance between compliance rigor and operational continuity.

8.3. Regular Stress Testing

Regulators may introduce periodic assessments of de-risking impacts, including evaluation of:

- liquidity conditions;
- correspondent banking stability;
- trade finance accessibility;
- systemic concentration of risk.

Integrating de-risking metrics into macroprudential analysis enhances policy responsiveness.

9. RECOMMENDATIONS FOR ADB, ASEAN, MAS AND HKMA

1. Include de-risking among systemic financial stability risks in supervisory and macroprudential frameworks.
2. Develop regional guidance on the application of proportionality in compliance responses.
3. Establish a monitoring working group on correspondent banking relationships.
4. Promote transparency of algorithmic decision-making within compliance systems.
5. Support initiatives aimed at strengthening financial inclusion and maintaining access to essential banking services.

10. CONCLUSION

De-risking is not merely a banking risk-management practice but a structural factor influencing regional resilience.

Maintaining a balance between strict compliance and the preservation of integrated financial flows represents a central challenge for Asia amid global regulatory and sanctions turbulence.

A systemic, proportionate, and coordinated approach can mitigate the risks of financial fragmentation and strengthen the resilience of the regional financial architecture.

APPENDIX A. TERMINOLOGY

De-risking — termination or restriction of financial relationships to minimize regulatory and reputational risk.

Defensive compliance — an excessively conservative compliance strategy aimed at minimizing exposure under uncertainty.

Financial fragmentation — segmentation of financial flows and infrastructure resulting from systemic restrictions.

APPENDIX B. DE-RISKING STRESS ASSESSMENT FRAMEWORK

1. Share and trend of terminated correspondent banking relationships.
2. Number of service refusals by client category.
3. Average delay in international payments.
4. Impact on financing of infrastructure and trade projects.
5. Trends in transaction costs and risk premiums.