

FACT FINDING SUMMARY FROM DE-RISKING SURVEYS:

WITHDRAWAL FROM CORRESPONDENT BANKING
WHERE, WHY, AND WHAT TO DO ABOUT IT

and

**REPORT ON THE G20 SURVEY ON DE-RISKING
ACTIVITIES IN THE REMITTANCE MARKET**



Summary Findings

- Withdrawal from Correspondent Banking - Where, Why, and What to Do About it
- Report on the G20 Survey On De-Risking Activities in the Remittance Market

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1818 H Street NW

Washington DC 20433

Telephone: 202-473-1000

Internet: www.worldbank.org

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De-risking: Fact-finding Summary

At the request of the G20 and the Financial Stability Board (FSB), and with the support of the Committee on Payments and Market Infrastructures (CPMI), the World Bank Group has led fact-finding work on de-risking – the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risk.

This analytical work has focused on two areas – restriction or termination of correspondent banking relationships (CBRs) (i.e. the provision of banking services by one bank to another) and account closures of money transfer operators (MTOs). Two reports reflecting the findings, analysis and related recommendations have been prepared and shared with the G20. Results of both reports show that de-risking is happening, though it hits specific countries, regions and financial services in varying degrees.

This paper will briefly summarize the key findings of both reports, as well as recommendations from these fact-finding efforts. The two complete reports are annexed to this summary. Annex 1 is the report entitled “Withdrawal from Correspondent Banking: Where, Why, and What to Do about It.” Annex 2 is the “Report on the G20 Survey on De-risking Activities in the Remittance Market.”

Key Findings – Withdrawal from Correspondent Banking: Where, Why, and What to Do about It

Roughly half the banking authorities and slightly more local/regional banks indicated a decline in CBRs. For large international banks the figures are significantly higher at 75 percent. The differences might be explicable in that a great majority of the large international banks were surveyed precisely because there had been mention of those institutions having terminated, albeit to varying degrees, their foreign correspondent banking relationships. The Caribbean seems to be the region most severely affected. The United States is most often mentioned as being home to correspondent banks that are withdrawing from foreign CBRs.

The products and services identified as being most affected by the withdrawal of correspondent banking relationships are: check clearing, clearing and settlement, cash-management services, international wire transfers and for banking authorities and local/regional banks also trade finance. In terms of client segments most significantly impacted, over 69 percent of the banking authorities responding to the survey indicated that money transfer operators and other remittance companies are most impacted, followed by small and medium domestic banks (44 percent) and small and medium exporters (26 percent). Respondents also specified other types of clients/client segments that were affected including retail customers, international business companies, and e-gaming/gambling.

The ability of financial institutions in affected jurisdictions to find alternative correspondent banks varied, but the majority indicated they were able to find replacements. Of the 46 banking authorities who responded to this question – 23 authorities indicated that their banks had found replacements and 8 indicated that they had found alternative means. Thirteen banking authorities indicated that they had been unable to find replacements.

The surveys also sought to obtain information from banking authorities and large banks on the extent to which they considered there to be an obligation to conduct due diligence on the customer’s customer(s) (often referred to as “KYCC” for “Know Your Customer’s Customer”) - in this case the customer(s) of the respondent bank. Large banks noted that although KYCC is not, in most countries, an obligation that can be found in the law, banks do conduct due diligence on the customer’s customer as a matter of practice in certain cases – just to be

on the safe side. However, it is not always possible to identify an underlying transaction – specifically when individual transfers are batched into one transfer, such as the case for remittances for instance, when the bank does one transfer that aggregates a number of smaller individual transfers.

The drivers of the decline in foreign CBRs can be divided into two groups: one category of causes that are more business related, explaining the decision to terminate a foreign CBR in purely economic terms, and another category of causes more regulatory and risk related, explaining the decision to sever ties with certain actors based on the level of ML/FT risk of the counterpart deemed unmanageable, concerns that one might fall foul of AML/CFT, international/regional sanctions or other legislation or regulations. The two are related – since higher risk can result in greater cost. While local/regional banks put more of an emphasis on the economic/business rationale for the decline, banking authorities and large banks emphasized both regulatory AML/CFT and business-related concerns.

Key Findings – Report on the G20 Survey on De-risking Activities in the Remittance Market

Data collected indicate that account closures for money transfer operators (MTOs) have become more pronounced over the last few years in some countries, including Australia, Canada, Germany, France, Italy, Mexico, the UK, and the US. The trend impacts more MTOs today than a few years ago; and both MTOs and banks report an increased trend of closed and/or restricted number of accounts between 2010 and 2014. A significant portion of MTOs declared that the MTO principal (28 percent of the respondents) or its agents (45 percent of respondents) can no longer access banking services. Of that smaller group of MTO principals without access, 75 percent are maintaining their presence in the market by using alternative channels to clear and settle the amounts at international level; the other 25 percent of MTO principal respondents are currently unable to operate regularly through bank channels.

The banks' responses point to four main drivers for MTO account closure: (1) profitability, (2) pressure from other actors (correspondent bank or law enforcement), (3) lack of confidence in the MTOs' procedures, and (4) reputational risk. The MTO responses point to four main drivers for account closure, as provided to them by the banks: (1) fear of regulatory scrutiny, (2) reputational risk, (3) profitability, and (4) fear of losing access to correspondent banking relationships. While these responses do not perfectly align, they are mutually reinforcing on most points. One area where it is clear there are differing views is the effectiveness of supervision of the MTO sector. Eighty-five percent of the governments that responded stated they believe banks can rely on adequate supervision of the MTO sector in order to inform their risk-based decisions on opening/maintaining accounts for MTO customers and 88 percent of MTO respondents agreed that their sector was sufficiently supervised. In contrast, only 52 percent of bank respondents judged that the MTO sector is sufficiently supervised and only 48 percent of bank respondents felt that they can rely on the supervision of the MTO sector to inform risk-based decisions on opening/maintaining accounts for MTO customers.

In this sample, according to the answers received from the governments, there are very few MTOs (principals or agents) that have been fined, suspended, sanctioned or received some other enforcement action for an AML/CFT-related violation between 2012 and 2014, however, the number has increased over time. Only two of the responding governments indicated that a bank operating in their country has been fined, suspended, sanctioned or has received some other enforcement action for an AML/CFT-related violation associated with their relationship with MTOs. In addition, 78 percent of MTO respondents indicated no record of sanctions or other enforcement actions related to AML/CFT.

Recommendations

The withdrawal from foreign CBRs and the closure of MTO accounts are complex and manifold phenomena. Some of the drivers are not susceptible to policy tweaks. A bank is completely justified not doing business because of business rationale, compliance costs or excessive risk. There are risks that should not be taken – and no policy intervention should try to dictate otherwise.

The issue to consider is whether in other cases, particularly where applicable rules or facts and circumstances are unclear, but there is in principle a business and risk-related rationale for engagement, there is something that authorities or the banks themselves could do to encourage the establishment of a business relationship. It is important to emphasize that this is a joint public-private responsibility that needs to be dealt with in partnership. Only such an approach with efforts by all actors, can help reverse the decline experienced in certain parts of the world.

While the two reports focused on different elements of the de-risking phenomenon, the recommendations have areas of convergence. Each annexed report contains multiple tailored recommendations. The recommendations provided below highlight the overlap for authorities to consider.

1) Monitor the status of correspondent banking and MTO access at jurisdiction level

Though not directly addressing the drivers of de-risking, it would improve the overall ability of governments and financial institutions to take action in an informed manner, if necessary, if countries were to more systematically gather information on de-risking – particularly on the status of foreign CBRs.

2) Ensure the effective implementation of international standards and enhanced understanding of risk

All jurisdictions must ensure that the legal and regulatory AML/CFT framework is in place and that their financial institutions are being effectively supervised for compliance with those obligations. For jurisdictions that believe they are unfairly being considered high risk because of past actual or perceived AML/CFT compliance lapses, it is especially important to demonstrate to their counterpart regulators, foreign financial institutions and public-at-large the reforms that have been implemented so as to correct misperceptions.

Respondent banks and MTOs seeking to establish or maintain banking relationships should improve their AML/CFT internal controls to reduce their risk profile.

National authorities and financial institutions need to make progress on the overall understanding and architecture for risk perception, allocation, and management. There is also a need to provide more explicit information on risks and risk management of the MTO sector in particular, notably residual risks, i.e. the amount of risk that remains even after controls are taken in to account.

3) Ensure the implementation of a risk-based approach – by supervisors and financial institutions

Supervisors and other enforcement authorities need to take a more direct role, in particular in the areas of proactive and effective risk-based supervision, as well as risk-based enforcement. In the course of their work, supervisors should ensure banks follow a risk-based approach, and also ensure the effective implementation of international AML/CFT standards. An unequivocal statement from national supervisors that there won't be a zero tolerance approach for failures to detect money laundering and setting out the tenets for a reasonable risk

assessment (to the extent supervisors have not already done so) for establishing correspondent banking relationships could provide banks with the comfort they say they are currently lacking. Supervisors should provide clarity on the extent to which, and under which conditions, they consider there to be an obligation to conduct due diligence on the customer's customer(s).

4) Increase communication and information sharing

Regulators and supervisors need to increase their communication and outreach on supervisory practices, to further contribute to more differentiated risk decision-making by banks.

With regard to correspondent banking relationships, there is a need to improve the information position of large banks. Banks should use technical tools to limit information challenges and lower costs. The CPMI will shortly be issuing a report on the use of enhanced technical tools to limit information challenges and the use of facilities offered by third parties to have the relevant information promptly at one's disposal and at much lower cost. This report will be an important contribution to this debate and its recommendations on the use of KYC utilities and the Legal Entity Identifier are endorsed here. Banks should also increase information exchange between respondent and correspondent banks and between the latter and supervisory authorities. Countries should consider how they might allow for such exchange of information without breaching data protection and privacy rules. (Banking) authorities of respondent banks should provide information on the country risk profile and how higher risks are being addressed.

With regard to MTOs, there is a clear need for more precise risk-based guidance to banks on the provision of bank accounts and banking services to MTOs and their agents. It would also be beneficial for MTOs to establish clear and transparent codes of conduct related to the implementation of legal requirements, establishing industry minimum standards above the bar set by legislation or regulation.