Correspondent banking relationships (CBRs) play an essential role in economies around the world, enabling local banks to access overseas products and carry out cross-border transactions. But while such relationships are an important feature of the global banking landscape, they are not set in stone.

Over the last couple of years, correspondent banks have chosen to restrict or terminate their relationships with local banks in a variety of markets. The term “de-risking” has been widely used to describe this phenomenon. However, some believe the term has unhelpful connotations—not least because correspondent banking relationships can be terminated or restricted for many different reasons.

Regardless of the terminology used, it is indisputable that many banks around the world have seen their CBRs terminated, leading to considerable challenges for banks and their customers. It is becoming increasingly clear that this trend is at odds with global goals for financial inclusion and that the withdrawal of services is forcing some customers to make payments using less regulated channels.

Banks may choose to restrict or rationalize their CBRs for a number of reasons. Guidance published by FATF in October 2016 cited supervisory penalties, changes in banks’ financial risk appetites and anti-money laundering (AML) compliance costs as key drivers of de-risking. Meanwhile, low interest rates have led to shrinking profit margins in correspondent banking—meaning that some banks may welcome the opportunity to exit a line of business, which is now less lucrative than in the past.

In November, following the publication of the FATF guidance, the Basel Committee began a consultation on proposed revisions to its guidelines on the Sound Management of Risks Related to Money Laundering and Financing of Terrorism. The consultative document notes, “The clarifications are proposed as the international community has been increasingly concerned about de-risking in correspondent banking, since a decline in the number of correspondent banking relationships may affect the ability to send and receive international payments, or drive some payment flows underground.”

Impact in the Caribbean

While banks around the world have been affected by the practice of terminating correspondent banking relationships, the impact has been more notable in some regions than in others. Research published in November 2015 by the World Bank found that the Caribbean “seems to be the region most severely affected” by this trend, with 69 percent of the local/regional banks surveyed reporting a moderate or significant decline in CBRs.

Correspondent banking relationships are particularly important for the Caribbean, as access to foreign financial markets is otherwise limited. At a global conference on correspondent banking, Gaston Browne, Prime Minister of Antigua and Barbuda, stated that the provision of correspondent banking services is a lifeline to Caribbean economies, “without which the region would be excluded from the global finance and trading system with grave consequences for maintenance of financial stability, economic growth, remittance flows and poverty alleviation.”

Over the last couple of years, the region has seen numerous correspondent banking relationships terminated, restricted or subjected to enhanced due diligence procedures. The decision to end or limit certain relationships may be a legitimate business decision from the point of view of individual correspondent banks. However, with the practice becoming increasingly widespread, local banks affected by this trend may struggle to obtain the relevant services from other banks—particularly in markets such as the Caribbean, where correspondent banking

services have historically been provided by a very small number of U.S. banks.

The consequences of this trend are considerable. Even if a replacement relationship can be found, banks, which have been de-risked, may still face certain challenges. For one thing, the costs involved in a new relationship may be significantly higher than under previous arrangements. For another, the termination of correspondent banking relationships typically carries a three month notice period—a timeframe which may not be sufficient for local banks to set up a replacement CBR.

Impact for end users

The impact of this trend is being felt unevenly across the Caribbean. Some money services businesses (MSBs) have been affected by having their accounts closed—at least one MSB has reportedly closed a franchise in the region as a result of concerns about de-risking. In some cases, de-risking has also reportedly led to the closure of accounts held by legal professionals and charities.

Where non-profit organizations (NPOs) are concerned, de-risking has impeded lifesaving assistance when charities have been unable to transfer funds to foreign countries, according to a report published by the Charity & Security Network in February 2017. The report makes a number of recommendations to address this issue, such as launching a multi-stakeholder dialogue to address NPO financial access, creating an NPO utility to streamline due diligence for financial institutions and creating a special banking channel to facilitate the movement of funds during humanitarian crises.5

Consumers also face significant challenges. People in the Caribbean may need to make payments to the U.S. for numerous reasons, such as paying for overseas university education for their children or obtaining medical care. At the same time, citizens working in the U.S. may wish to send money back to their home countries in order to support their families and cover mortgage payments.

Taken to its extreme, the termination of correspondent banking relationships could have severe consequences across society. If university fees or accommodation costs cannot be paid, young people may be prevented from advancing their education—ultimately becoming a lost resource for the region. If mortgage payments are missed, people may lose their homes. If individuals cannot access essential medical attention, their conditions may worsen, possibly with fatal consequences.

Inevitably, if people are unable to make payments through legitimate channels, they will seek other methods of doing so—whether that means using money remittance services or carrying suitcases full of cash across borders. Unlike the mainstream banking system, such methods can be difficult to track, as well as resulting in greater risks for the individuals concerned. Ironically, the use of less regulated channels can lead to greater opportunities for money laundering and criminal activity—the very thing that stringent AML regulation is intended to prevent.

Seeking solutions

In light of these concerns, efforts are underway to address the challenges associated with de-risking. From diplomatic discussions to the creation of new electronic systems, countries around the world are taking steps to implement new structures and solutions.

In some cases, central banks are taking a more active role in supporting local banks. Some countries are adopting new anti-money laundering/counter-terrorist financing (AML/CTF) legislation in order to address correspondent banks’ concerns about risks in the relevant markets. At the same time, there is a greater awareness of the need for effective dialogue between correspondents and respondents in order to increase awareness of both parties’ challenges and concerns.

In a report published in 2016, the World Bank Group and ACAMS made a number of recommendations, including the need for greater clarity and consistency about regulatory expectations, greater transparency on how regulators deal with infringements and the harmonization of regulations to facilitate global compliance. The report also suggested that there should be a direct line of communication between the compliance departments of respondent and correspondent banks, and that correspondent banks should be transparent about their reasons for terminating CBRs.6

Meanwhile, where the Caribbean is concerned, a discussion paper published in 2016 by Caribbean Development Bank set out a number of possible short-, medium- and long-term goals, which should be targeted by regional stakeholders.7 These included recovering lost CBRs and preventing the loss of current CBRs, as well as making CBRs more cost-effective for correspondent banks. The report also highlighted the importance of increasing understanding of the region’s AML risk profile and diversifying the range of robust CBR providers to regional institutions.

Increasing transparency

At an individual bank level, local banks are considering which measures they can take to protect their own correspondent banking relationships. While it is impossible to guarantee that a specific relationship will not be terminated, banks can reduce the likelihood of this outcome or increase the likelihood of securing alternative relationships by communicating with correspondent banks in a more transparent way.

By sharing information more effectively, smaller banks can help to reduce their correspondent’s due diligence costs, helping to allay concerns about the profitability of specific relationships. Practical measures might include making sure that sufficient controls are in place, as well as building a gold standard data set which can be used to share consistent information with counterparties.

Experts have also underlined the role that industry utilities for know your customer (KYC) and sanctions screening can play in increasing transparency and sharing information effectively, with central banks leading community initiatives to join utilities in some markets. Shared platforms can act as a repository of relevant data, enabling counterparties to source trusted, up-to-date KYC information and thereby provide greater comfort to correspondents. With a number of different utilities available, it may be prudent for banks to submit their data to several platforms, as long as they can ensure that their data is fully current and that each utility is updated with the same information.

Banks should be aware that taking the necessary steps to distinguish themselves as a trustworthy and compliant banking partner in a higher risk market can actually be a source of competitive advantage. The following recommendations should be considered when banks are seeking to protect their CBRs:

- Work with regional development banks, central banks and industry associations to understand the specific challenges and how best to address these.
- Ensure that you have systems and processes in place to screen transactions, customers and PEPs in line with global compliance standards. Be able to demonstrate that such screening is taking place and being done effectively.
- Join an industry KYC utility. In many cases, the decision whether or not to de-risk is a business one. For example, does the business case for maintaining a relationship justify the cost of performing KYC due diligence and other compliance activities? By making your information available in a utility, you demonstrate transparency and reduce your counterparty’s compliance costs.
- Use data analysis and reporting to demonstrate to your counterparties where your payment flows are coming from and going to (including ‘nested’ relationships). Be prepared to explain the legitimacy of such flows and answer any questions your correspondent bank might have.
- Talk to your correspondent bank proactively to understand their basis for making de-risking decisions. Agree on an action plan to address any concerns and execute this to demonstrate your commitment to transparency and compliance.

Conclusion

While de-risking can happen for different reasons, it has become apparent that measures originally intended to combat the risk of money laundering and terrorist financing have contributed to the termination of some CBRs. This, in turn, makes it more difficult for payments to be made through legitimate channels—ultimately increasing the risk that illicit transactions will occur. As the industry seeks to overcome these issues, financial inclusion needs to remain front and center, not only because it is essential to society, but also as a means of minimizing illicit flows.

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