European Banking Industry Committee

European Banking Federation (EBF) • European Savings and Retail Banking Group (ESBG) • European Association of Co-operative Banks (EACB) • European Mortgage Federation (EMF) • European Federation of Building Societies (EFBS) • European Federation of Finance House Associations (Eurofinas)/European Federation of Leasing Company Associations (Leaseurope) • European Association of Public Banks (EAPB)

To: Financial Action Task Force Secretariat

Email: pdg@fatf-gafi.org

Brussels, 5 August 2016

Re: EBIC response to the FATF Consultation of the Private Sector on Correspondent Banking

Dear Sir or Madam,

The European Banking Industry Committee (EBIC) would like to thank the Financial Action Task Force (FATF) for providing it with the valuable opportunity to comment on the confidential document titled "FATF Consultation of the Private Sector on Correspondent Banking" communicated by the FATF Secretariat on 7 July 2016. Please find below our answers and comments to the specific questions raised in the consultative document.

We would very much appreciate if the FATF could consider our comments while finalizing the guidance document. We would welcome the guidance document to suggest a single FATF standard request-for-information-form that lists the concrete data set that has to be requested between correspondent banks. Should you require further information concerning the issues stated above please do not hesitate to contact us.

Yours sincerely,

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EBIC answers to FATF questions on correspondent banking

1. **Definition of correspondent banking** (Para. 13 a): *please share your views on the current FATF definition of correspondent banking (FATF Glossary). Would a change in the definition, and more specifically on the scope of the definition, help financial institutions address some of the de-risking challenges, or would it cause more uncertainty? If relevant, please explain why a change in definition would help to address some of the de-risking challenges, and give your views on whether this would have a significant, moderate or minimal impact on de-risking?*

EBIC would welcome either a more precise and narrower definition or to fully align this definition with the requirements imposed by the 4th Anti-Money Laundering Directive (4. AMLD (No. 2015/849)) as a common basis. This would ensure a comprehensive understanding within the financial market.

The current definition is not clear enough and leads to various interpretation, as it does not list the banking services, which are considered as correspondent banking; e.g. banking services could be understood as the mere exchange of SWIFT RMAs or as the maintenance of an account relation. Also the definition of correspondent banking within the US regulatory framework already goes beyond the term "bank" and the FATF range of services as such. Therefore, we would seek further explicit guidance what other obliged entities and actual types of service fall in the scope of correspondent banking. Current guidance is fairly silent on the actual underlying risk trigger for treating a client relationship as correspondent banking relationship. It would be beneficial to have much more explicit guidance around the third party element beyond the respondent (KYCC) and how this would trigger for example in the context of a broker dealer, fund or asset manager the requirement to apply correspondent banking enhanced KYC standards.

Additionally, the definition should also refer to the regularity of business with another bank. Usually cash management, custody, trade finance or capital markets relations have a recurring character and lead to a regular and constant flow of business between two banks. The same applies for business relations that require counterparty limits. On the other hand, there are "one-off" activities, as offered on the capital markets sales side (i.e. sale of a bond or a share), which should not fall under the definition.

Moreover, EBIC would like to point out another very important aspect of the issue: The fundamental problem of de-risking lies in the fact that Recommendation (Rec.) 13 of the revised FATF-40 implicitly requires banks to assign correspondent banking to the high risk category irrespective of the fact whether the bank is based in a FATF-compliant jurisdiction or not. By doing so, the maneuvering space for banks to apply a genuine risk based approach to correspondent banking and to determine the actual risk level of a correspondent financial institution (as its business partner) on a discretionary basis by applying standard and internationally recognized customer due diligence (CDD) procedures has been significantly reduced, if not completely eliminated.

In view of the aforementioned banks in general do not have any other alternative than to de-risk by severing their links with correspondent financial institutions in third country jurisdictions where the legal framework is not perceived to be in line with the standards of the FATF-40. As the regulatory burden of maintaining correspondent banking relationships with banks in FATF-compliant jurisdictions is already very high, banks do not feel the necessity to enter into or retain correspondent banking relationships with financial institutions in non-compliant or high risk jurisdictions that entail additional CDD and documentation requirements on top of the already existing enhanced CDD requirements for correspondent institutions based in FATF-compliant

jurisdictions. EBIC is of the opinion that unless the FATF envisages a paradigm shift in Rec. 13 to the effect of introducing a genuine risk based approach (i. e. by allowing banks to assign low, medium and high risk categories) to deal with correspondent banking relationships any other change of definition as suggested in question 1 would not help to address some of the de-risking challenges. Without a paradigm shift, however, the benefits of de-risking would always outweigh the costs of maintaining correspondent banking relationships with financial institutions based in – from a FATF point of view – problematic or non-compliant jurisdictions.

The current lack of risk differentiation moreover does not consider different risks associated with unilateral and dual correspondent banking relationships (by the way not reflected in the definition). In the case of a unilateral relationship the correspondent bank offers services to the respondent bank (generally foreign currency transactions) without being in a reciprocal relationship (in this case where the respondent bank would also offer foreign currency transactions to the correspondent bank). Because of the lacking risk for the respondent bank which does not perform any activities for the correspondent bank, this form of relationship- under consideration of other risk factors - can be considered lower risk than a dual correspondent banking relationship.

2. **Correspondent banking risk indicators** (Para 16): *please provide your views on the usefulness and relevance of the reference to the BCBC list of correspondent banking risk indicators (*Guidance on *Sound management of risks related to money laundering and financing of terrorism*, Annex II on correspondent banking, para 7)*, and suggest other possible indicators to consider when determining the risk profile of correspondent banking relationships. If some kinds of correspondent banking products or services are considered lower risk for ML/TF than others, please provide examples and explain why the ML/TF risk is lower. If this is not possible since ML/TF risk will vary on a case-by-case basis, please state such or explain.*

The list of correspondent banking risk indicators provided by the aforementioned Guidance of the Basel Committee on Banking Supervision (BCBS) tries to capture the complexity of the correspondent banking business. However, from the outset the BCBS document applies the same high risk angle to the issue. Although the risk factors listed in Annex II para 7 of the BCBS document are helpful in assessing the risks of respondent institutions they do not help to overcome the aforementioned structural flaw of generally assigning a high risk category to correspondent banking relationships as done by the FATF-40 (see answer to question 1). According to EBIC it is hard to accept that correspondent financial institutions based in the European Union (EU) as a single market and jurisdiction with harmonized AML/CFT legislation should regard themselves mutually as high risk.

Therefore, we suggest applying the risk based approach also to correspondent banking activities. At least, for a union of states like the EU, with harmonized AML/CFT legislation in line with FATF recommendations, safe harbour provisions should be considered (see below).

Regarding the BCBS list of correspondent banking risk indicators a reference in the guidelines would generally be useful. EBIC would like to suggest further to also consult with SWIFT regarding a sense full inclusion of the SWIFT KYC Registry into the guidelines.

EBIC suggests to take into consideration the following possible ”other” indicators relating to Para 7 (c):

- Does the respondent bank issue bearer shares?
- Does the respondent bank ask their customers, whether they issue bearer shares?

- Does the issuance and passing on of bearer shares have to be registered or reported to a competent authority?

As regards lower risk examples, cash intensive business products could be at the first glance considered as high risk ones. However, implementing risk mitigating measures like transaction monitoring could lead to achieving a medium risk classification for high risk products. On the other hand it should be allowed for banks to consider a lower ML/TF-risk rating overall on a case by case basis where the correspondent bank clearly understands the underlying party of the respondent bank from a KYC perspective (e.g. that party has also a relationship with the correspondent bank).

3. **Assessment of the respondent institution's AML/CFT controls** (Para 19): *please confirm that the proposed high-level description reflects the process which correspondent institutions usually apply, and provide information on how this is being done in practice.*

Para 19 requires that the correspondent institution, in addition, "… *should critically assess the respondent institution's AML/CFT controls. In practice, such an assessment could for example, involve reviewing the respondent institution's AML/CFT policies and procedures and their implementation to assess if they are in line with the applicable AML/CFT laws and regulations in the jurisdiction of the respondent institution, including targeted financial sanctions.*"

In order to implement the measures suggested in para 19 banks would have to set up specific departments that are solely tasked with the assessment of the issues addressed in para 19. The establishment of such departments would inevitably entail further red tape on top of the administrative burden resulting from the already existing enhanced CDD measures and assessments that are applied by correspondent institutions to respondents based in FATF-compliant jurisdictions. Again, EBIC would like to emphasize that the incentives for de-risking would be convincing enough to outweigh the costs of maintaining correspondent banking relationships with financial institutions based in – from a FATF point of view – problematic or non-compliant jurisdictions.

As an alternative we would welcome the guidance document to suggest a single FATF standard request-for-information-form that lists the concrete data set that has to be requested between correspondent banks. A starting point with a possibly workable solution could be the extension and inclusion of the catalogue of the "*Wolfsberg Anti-Money Laundering Principles for Correspondent Banking*" so as to include some of the practical elements of the FATF proposed in para 19. EBIC strongly suggests that this avenue be reviewed by a dedicated task force of the FATF (composed of FATF representatives, practitioners of the Wolfsberg Group as well as from the Cooperative and Savings Bank Groups) before rushing to premature conclusions concerning the measures proposed in para 19. Such a review could provide useful insights as to how the Wolfsberg Principles and the Wolfsberg Questionnaire could be emulated (with the necessary modifications) to a FATF standard in order to enable financial institutions to

- manage their correspondent banking risks effectively,
- exercise sound business judgement with respect to their clients,
- prevent the use of their worldwide operations for criminal purposes and
- minimize their administrative burden

within a risk based framework.

4. **Nested relationships** (Para. 21): please provide information and examples of:

- *monitoring measures applied by correspondent institutions to detect undisclosed nested relationship*
- *process put in place by correspondent institutions to understand the respondent control framework with respect to nested relationships*

A risk-based approach is implemented to identify nested relationships through KYC questionnaires as well as through monitoring. The identity of downstream financial institutions is requested on a risk based approach at the time of on-boarding and with each subsequent review of the correspondent banking client relationship. Once undisclosed nested relationships are identified, special investigation on those parties and their related payment flows are launched on a case-by-case basis. Such investigation may lead to business restrictions or an exit being imposed.

A risk-based approach is currently also implemented to understand the respondent's control framework. This is done via the assessment of the respondent's control framework through KYC questionnaires as well as screening of third party names for ML/TF relevant offences and beyond.

5. **Enhanced due diligence measures** (Para. 26*): please clarify if, in addition to the interaction with the target respondent institution's management and compliance officer(s), financial institutions can and do also get information from a foreign supervisor in practice?*

Generally getting further information (for example to verify the implementation of AML standards or the assessment of local country-specific AML standards) from a foreign supervisor seems to have lower practical relevance. If the requested information or documentation could not be obtained via the correspondent bank it is questionable if a request to a foreign supervisor would be successful. However, a discussion with the regulator of the respondent might be required in certain higher risk situations. Specific investigations might involve such engagement as well.

Moreover, para 26 requires that where "… *the correspondent institution has identified higher risks than would normally be expected of a correspondent banking relationship, enhanced measures may be appropriate according to the risks identified by the correspondent institution* …" In some circumstances "… *closer interactions (conference phones or face-to-face meetings) with the respondent institution's management and compliance officer(s)* …" are considered to be appropriate measures.

Furthermore, para 27 requires that in all cases "… *the correspondent institution should obtain approval from senior management before establishing new correspondent relationships, as required by FATF Recommendation 13* …"

As to the issue of "*closer interactions*" and "*senior management approval*" EBIC would like to obtain specific clarification concerning the following issues:

- The frequency of the aforementioned "*interactions*" should be – in a risk based framework – geared to the level of risk represented by the correspondent financial institution (see our comments and proposals with regard to question 2).

- The "*interactions*" should, depending on the level of risk, provide for a graded escalation approach as follows: (1) Initiation of the CDD process on the basis of a standard questionnaire; (2) conducting conference phone calls if additional information is required or the information provided in step (1) appears to be unsatisfactory/incomplete and (3) scheduling face-to-face meetings and on-site visits if measures suggested under steps (1) and (2) prove to be generally unsatisfactory.

- From an EU law perspective (i. e. 4.AMLD) the requirement of "*senior management approval*" as the appropriate level of seniority for sign off on the basis of increased risk associated with the business relationship is not prescribed. The 4. AMLD simply requires "*senior level approval*". In the opinion of EBIC a risk associated and case by case adjustment of the locus of "*senior management approval*" seems to be warranted only in those cases in which the appropriate degree of seniority of the decision-making level is not discernible or not ensured.

- Finally, it should be emphasized that in case of the EU, which is considered a supra-national jurisdiction by the FATF (see Interpretative Notes to Recs. 6 and 7 FATF-40), safe harbour standards/provisions are required. The standards should specify that the designation of financial institutions of a union of states with harmonized AML/CFT law in line with FATF recommendations, e.g. EU based correspondent banks as "low risk" will be deemed not to violate the standards of the FATF-40 and subsequent supranational and EU-Member State AML/CFT legislation.

Question to the private sector (Para. 30): *please provide information on the types of relationships for which sample testing is conducted and how the sample testings are conducted in those cases*

Sample testing might take place via onsite visits after an unusual amount of SAR inquiry that could not be cleared to satisfaction.

Question to the private sector (Para. 34): *please confirm that this list is appropriate and reflects business practices.*

This is confirmed business practice, however, with some elements considered risk-based.

6. **Request for additional information on MVTS customers** (Para 45): *please clarify if, when the respondent processes the transactions of its customers on a group basis, the correspondent institution usually gets access to the identity of the respondent's underlying customers following a request for additional information.*

In practice financial institutions may ask MVTS to provide information about their client structure and due diligence measures (KYCC). In addition, agreement on the process to disclose the names of the underlying customers in specific transactions may be required under a risk-based approach. However, it is important to stress that the use of RFIs may give cause additional administrative burden for correspondent financial institutions that may potentially jeopardize the functioning of the correspondent banking business model. EBIC would, therefore, like to point out the following issues that banks may face:

- The RFI should in case of a specific transaction not be sent to all parties involved in the transaction (as suggested in the long list of questions under para 34). It should be directed towards the relevant party involved in the transaction chain that is not providing satisfactory information to clear the transaction in question.

- Para 35 goes clearly beyond the scope of Rec. 16 (wire transfers) and its interpretative note as it prescribes the filing of a suspicious transaction report (STR) if the respondent fails to answer to an RFI in a timely fashion and to provide the required information to the correspondent financial institution. EBIC would like to question the rationale and value added of this requirement as the information contained in the filed STRs are due to evident lack of cooperation between the financial intelligence units (FIU) not or not extensively shared among the authorities.

- As to the requirements of para 36 et seq. EBIC proposes to develop a model written agreement between correspondent and respondent institutions before providing correspondent banking services by competent organizations (e. g. International Chamber of Commerce) and standard setters, such as the FATF. Such a move towards an agreed international standard would ensure not only a robust and legally secure framework for providing correspondent banking services but also a level playing field.

The measures concerning MVTS customers suggested in para 45 could – if implemented – result in further red tape. This is because MVTS customers maintaining an account at a financial institution pool specific money transfer orders of their customers to different jurisdictions in the world in the said account before sending the amounts in several batches from the said account to the beneficiaries of the money transfer. Introducing risk identification, verification, monitoring and risk mitigation measures as suggested in para 45 would due to the enormous administrative burden involved render the correspondent banking business utterly unattractive, if indefeasible. Moreover, such measures would deal a fatal blow to the business relationship between correspondent financial institutions and their MVTS customers and would inevitably result in further de-risking with regard to certain financial service providers.

EBIC furthermore suggests aligning the abbreviation MVTS with the international standards. Using PSP or MSB instead of MVTS would be more preferable, as there is already an existing definition of PSPs and MSBs in the US.

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