

February 22, 2017

Via Electronic Mail

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel Switzerland

Re: Consultative Document – Revised annex on correspondent banking

Ladies and Gentlemen:

The Clearing House Association L.L.C. and the Institute of International Bankers (collectively, the “**Associations**”)¹ appreciate the opportunity to provide our comments and recommendations on the consultative document proposing revisions to Annexes 2 (“Correspondent banking”) and 4 (“General guide to account opening”) of the Basel Committee on Banking Supervision (the “**Committee**”) guidelines on the *Sound management of risks related to money laundering and financing of terrorism* (the “**Revisions**”)² in response to the Financial Action Task Force’s (“**FATF**”) guidance on correspondent banking services issued in October 2016 (the “**FATF Guidance**”).³ Our member banks together operate a significant portion of the correspondent banking network worldwide and recognize the importance of correspondent banking to the smooth functioning of the international financial system. In that regard, we have been actively participating in efforts to identify and manage the money laundering and terrorist financing risk of correspondent banking, including through The Clearing House’s publication of the *Guiding Principles for Anti-Money Laundering Policies and Procedures for Correspondent Banking*⁴ (the “**Guiding Principles**”) and co-sponsorship of the

¹ Descriptions of the Associations are provided in *Annex A* of this letter.

² Bank for International Settlements, *Consultative Document—Revised Annex on Correspondent Banking* (Nov. 2016), available at <http://www.bis.org/bcbs/publ/d389.htm>.

³ FATF Guidance, *Correspondent Banking Services* (Oct. 2016), available at <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-Correspondent-Banking-Services.pdf>.

⁴ The Clearing House, *Guiding Principles for Anti-Money Laundering Policies and Procedures in Correspondent Banking* (Feb. 2016), available at <https://www.theclearinghouse.org/issues/articles/2016/02/20160216-tch-guiding-principles-for-aml>. The Guiding Principles were originally published in 2002 and updated in 2016 to reflect changes in statutes and regulations, increased supervisory expectations and heightened regulatory scrutiny of correspondent banking in the intervening years.

*Statement on Payment Message Standards*⁵ to allow for greater transparency in payment messages.

We share the concerns, recognized in the Revisions, about de-risking in correspondent banking and agree that the perpetuation of such a phenomenon could lead to significant consequences, including affecting the ability of certain countries and industries to send and receive international payments and driving some payment flows underground. We also note that de-risking is in part a reaction to government and supervisory characterizations of correspondent banking as a high risk business and the evolving standards within the international community. We appreciate the Committee's efforts, through the Revisions, to provide clarity to correspondent banks regarding anti-money laundering and counter terrorist financing ("AML/CFT") requirements. In that regard, our member banks wish to provide the following comments on the Revisions.

I. The definition of correspondent banking used in the Revisions is overly broad and should be narrowed to encompass only activities that generate the particular AML/CFT risks the Revisions seek to address.

The Revisions currently define "correspondent banking" by referencing the definition in the FATF Guidance—"the provision of banking services by one bank ... to another bank[.]"⁶ U.S. regulations utilize a similarly broad definition.⁷ However, we submit that AML/CFT risks in correspondent banking—the subject of annexes 2 and 4—arise when banks are providing *transaction services* to other banks for the benefit of those banks' customers. We are concerned that these broad definitions encompass relationships where banks deal with one another as principals, such as when they provide certain interest rate swaps or foreign exchange services for hedging purposes, rather than when they provide third-party services to one another, such as clearing payments or processing other transactions involving a correspondent bank customer's customers. The necessary risk analysis when a bank acts as a principal is fundamentally different from that required when a bank processes third-party payments. When dealing as a principal, a bank assesses AML/CFT risk based on the characteristics of the other bank. The positions set forth below address the risks posed by banks' provision of third-party transaction services, not instances where banks act as principals, as the assessment of risk differs. Engaging with a bank that is acting on behalf of a third party requires an assessment of an additional layer of AML/CFT risk posed by the indirect involvement of another party with whom the bank has no relationship, but which carries its own set of AML/CFT risk factors. Many "banking services" provided by one bank to another may not entail these additional risks. For example, interest rate and foreign exchange swaps among banks and financial institutions, when used as tools to hedge risk, do not involve the processing of transactions on behalf of third parties and, as such, may not present the same degree of AML/CFT risk. Similarly, while acting on behalf of other banks in a syndicated lending transaction requires sending payments to other participating banks, such

⁵ Wolfsberg Group, *Clearing House Statement on Payment Message Standards* (2007), available at [http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg_NYCH_Statement_on_Payment_Message_Standards_\(2007\).pdf](http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg_NYCH_Statement_on_Payment_Message_Standards_(2007).pdf).

⁶ FATF Guidance, *supra* note 3, at 7.

⁷ 31 C.F.R. § 1010.605(c).

activity does not involve the same level of risk as payment processing on behalf of a third party. These activities, despite presenting different risk profiles than processing transactions on behalf of third parties, are encompassed by the Revision's current definition.

Because of regulatory focus on AML/CFT issues in correspondent banking, there are multiple formulations of the definition of "correspondent banking." A number of these are described in the consultative report on correspondent banking issued in October 2015 by the Committee on Payments and Market Infrastructures of the Bank of International Settlements ("CPMI"). In that report, the CPMI defined correspondent banking "in general terms as 'an arrangement under which one bank ... holds deposits owned by other banks ... and provides payment and other services to those respondent banks.'"⁸ The CPMI also noted the European Central Bank's ("ECB") definition of correspondent banking as "agreements or contractual relationships between banks to provide payment services for each other."⁹ Finally, the CPMI referenced the Wolfsberg Group's definition of correspondent banking as "the provision of a current or other liability account, and related services, to another financial institution, including affiliates, used for the execution of third party payments and trade finance, as well as its own cash clearing, liquidity management and short-term borrowing or investment needs in a particular currency."¹⁰ We also note that The Clearing House's Guiding Principles define a correspondent account as "an account established by a Bank for a Foreign Correspondent Banking Customer to receive deposits from, or to make payments or other disbursements on behalf of, the Foreign Correspondent Banking Customer, or to handle other financial transactions related to such Foreign Correspondent Banking Customer."¹¹ Though they differ in specificity, and some are broad enough to encompass principal transactions between banks, we note that each of these definitions includes the provision of third-party payment or transaction services—an aspect not specified in the Revisions' broad definition.

We recommend that the Committee revise the current definition of correspondent banking in the Revisions to better align with the more detailed approach taken by The Clearing House, the Wolfsberg Group and others. In particular, we recommend making a distinction between the provision of third-party services and engaging in transactions as principals. As noted, banks interact with one another in a variety of ways—the more expansive the definition of correspondent banking, the greater the need will be for separate risk rankings for the various services and activities captured within that definition. Indeed, the broad definition of correspondent banking coupled with a lack of risk differentiation in U.S. regulations has contributed significantly to the de-risking phenomenon. Should the Committee opt to retain the broad definition set forth in the Revisions, we ask that the Committee recognize the fact that the definition encompasses activities with varying risk profiles, not all of which will require the

⁸ Bank for International Settlements, *Consultative Report—Correspondent Banking* (Oct. 2015), available at <http://www.bis.org/cpmi/publ/d136.htm>.

⁹ European Central Bank, *Ninth Survey on Correspondent Banking in Euro* (Feb. 2015) at 7, available at <https://www.ecb.europa.eu/pub/pdf/other/surveycorrespondentbankingineuro201502.en.pdf>.

¹⁰ The Wolfsberg Group, *Wolfsberg Anti-Money Laundering Principles for Correspondent Banking* (2014) at 1, available at <http://www.wolfsberg-principles.com/standards.html>.

¹¹ Guiding Principles, *supra* note 4, at 28. The Guiding Principles define a "Foreign Correspondent Banking Customer" as "any Foreign Bank for which a Bank establishes, maintains, administers or manages a Correspondent Account." *Id.* at 30.

same degree of due diligence and monitoring. In keeping with our support for a public-private partnership approach to AML/CFT compliance, discussed further in Part II(D) below, we suggest that industry engage in a dialogue with regulators with a view toward developing a consensus as to the risk rankings of the diverse range of services that fall within the current definition[s] of correspondent banking. Such a consensus would not only provide greater clarity to correspondent banks regarding their AML/CFT compliance obligations, but would be a useful basis for discussion between banks as they negotiate their service agreements.

II. The Committee should clarify aspects of its risk management principles, acknowledge the limitations of the risk-based approach and encourage local authorities to permit banks to comply with regulatory expectations by applying the principles in good-faith.

Correspondent banking is an integral part of the international payment system, but we also recognize that the nature of correspondent banking makes the system uniquely vulnerable to criminal activity, including, in particular, money laundering and terrorist financing activities. In the international attempt to balance these competing attributes, the de-risking phenomenon has been widely discussed as a serious problem that threatens to hinder financial inclusion and drive money laundering and terrorist financing into informal, less secure and less visible channels.¹² It is our firmly held view, and we encourage the Committee and other regulatory bodies to acknowledge, that de-risking is very often the result of a bank's prudent assessment of its own risk tolerance in light of its own risk management and regulatory expectations—and that, in this respect, de-risking is a function of government policy and supervisory practices.¹³ We also note that internal audits of regulatory compliance, which occur more frequently than regulatory examinations, also contribute to de-risking, as adverse audit findings may be as impactful, disruptive and expensive to resolve as an adverse regulatory finding. The effect is particularly acute for U.S. financial institutions, including the U.S. banking operations of foreign banks, which are required to have independent testing procedures as a part of their AML/CFT programs,¹⁴ which banking regulators may rely on in regulatory examinations. Thus, we submit that, in order to effectively address the de-risking phenomenon, governments and regulators should continue to clarify regulatory expectations in consultation with the correspondent banking community, and should provide banks with greater certainty that the banks' good-faith application of clear regulatory guidance and expectations will ensure that banks are found by their regulators and auditors to be in compliance with those requirements.

¹² See, e.g., Speech By Christine Lagarde, Managing Director of the International Monetary Fund, Relations in Banking—Making It Work for Everyone (July 18, 2016), *available at* <http://www.imf.org/en/News/Articles/2016/07/15/13/45/SP071816-Relations-in-Banking-Making-It-Work-For-Everyone>.

¹³ See The Clearing House, Letter to Robert Lindley, CPMI Secretariat, Re: Comments in Response to Consultative Report—*Correspondent Banking* (Dec. 7, 2015), *available at* <https://www.theclearinghouse.org/issues/articles/2015/12/20151207-tch-comments-to-cpmi-on-aml>.

¹⁴ See 31 C.F.R. § 1020.210(b).

A. The Committee should clarify that the Revisions allow for flexibility in the application of the suggested risk indicators and that the Revisions are consistent with a risk-based approach to ongoing monitoring.

The Revisions request feedback as to whether it would be useful for the Committee to elaborate further on how a correspondent bank should conduct the assessment of a respondent bank's AML/CFT policies and procedures, such as via the use of internal audit reports.¹⁵ We appreciate and fully support the Committee's efforts to offer guidance that clarifies regulatory expectations. However, we are also concerned that overly detailed, inflexible or prescriptive guidance is counterproductive and inconsistent with a risk-based approach, as it promotes "a more rules-based and tick-the-box approach to risk management."¹⁶ Therefore, while we think that it would be useful for the Committee to further elaborate, we recommend it do so in a high-level, principles-based manner consistent with the flexibility banks require to implement a risk-based approach.

Because the Committee's question specifically references the use of internal audit reports, we note that any expectation that a correspondent bank obtain such reports from its respondents would create significant business-related and legal barriers to the correspondent relationship that would likely contribute to de-risking. Internal audit reports often contain confidential supervisory and proprietary information, implicating data privacy concerns and creating conflicts of law issues. Further, publically-traded banks must consider the potential impact under federal securities laws of providing any material non-public information. Indeed, most of these banks already require confidentiality agreements with upstream correspondents seeking AML program information. We are concerned that providing internal audit reports may be construed under applicable securities law as a disclosure of material non-public information, adding significant regulatory hurdles to the already burdensome process of ensuring the confidentiality of shared information.

Understandably, respondent banks often refuse to provide internal audit reports, and an audit request can be prohibitively expensive. Further, even if an internal audit report were provided, it would have to be heavily sanitized to avoid the legal and business concerns highlighted above. As such, the report would have little added utility—most of the remaining information would be that which correspondent banks already obtain through tools such as the Wolfsberg questionnaire and similar requests for information. Given the considerations outlined above, we respectfully request that the Committee *not* include internal audit requests as an expectation and remove its reference to internal audit reports in the Revisions. In addition to our general response to the Committee's question, we outline below some additional related suggestions.

In paragraph 7 of the Revisions, the Committee lists "[r]isk indicators that correspondent banks should consider in their risk assessment." We respectfully submit that this language should be revised to better emphasize banks' flexibility with respect to the application of these

¹⁵ Revisions, *supra* note 2, at 6.

¹⁶ Financial Action Task Force, *Guidance for a Risk-Based Approach: The Banking Sector* (Oct. 2014) at 10, available at <http://www.fatf-gafi.org/publications/fatfrecommendations/documents/risk-based-approach-banking-sector.html>.

indicators. As the FATF Guidance notes, “[t]he risk factors included in Annex II of the BCBS Guidelines on *Sound management of risks related to money laundering and financing of terrorism* are *examples* of factors which correspondent institutions *can* use when assessing the risks of their correspondent banking relationships.”¹⁷ The Guiding Principles provide that banks’ risk assessments should “consider all relevant factors, including [the suggested factors], *as appropriate*.”¹⁸ In order to better emphasize this necessarily flexible approach to risk assessment, we suggest that the Committee add an “as appropriate” caveat such that the introduction to the paragraph reads:

“Risk indicators that correspondent banks should consider, as appropriate, include ...”

For example, when evaluating a respondent bank’s general portfolio makeup, the fact that they provide banknotes to clients may not be relevant where they are offered only to a select low-risk subset of the respondent’s clientele. Additionally, while public enforcement actions can be useful in some respects, and may prompt enhanced due diligence in certain instances, they are not always relevant in the context of the services provided in a correspondent banking relationship. Without any caveats allowing for discretion, the list of risk indicators could have an unexpected chilling effect on correspondent banking, turning risk management into a “rules-based and tick-the-box” exercise.¹⁹ While we agree that these indicators should be considered, we note that circumstances may exist that allow for diminishing their impact, and respectfully request that the Committee alter its language to better accommodate such circumstances.

Similarly, paragraph 25 notes that monitoring policies, procedures and systems should be established to “detect any financial activity that is not consistent with the purpose of the services provided to respondent banks or any financial activity that is contrary to commitments ...between the correspondent and the respondent bank.”²⁰ While we agree that these are important purposes for which policies, procedures and systems should be designed, as discussed further in section D of this Part II below, we believe it must be recognized that banks cannot catch everything. We therefore suggest altering the language to better reflect a risk-based approach to monitoring by indicating that policies, procedures and systems should be:

“reasonably designed to detect financial activity that is not consistent ...”

This language would maintain the emphasis on the important functions of correspondent banks’ policies, procedures and systems while also highlighting the risk-based nature of the approach that “is the cornerstone of an effective AML/CFT system.”²¹

Finally, we note that an emphasis on flexibility is particularly important with respect to cross-border correspondent relationships, where international data privacy and bank secrecy laws, confidentiality restrictions and logistical issues may operate as impediments to risk

¹⁷ FATF Guidance, *supra* note 3, at 10 (emphasis added).

¹⁸ Guiding Principles, *supra* note 4, at 12.

¹⁹ FATF Guidance, *supra* note 3, at 10

²⁰ Revisions, *supra* note 2, at 7.

²¹ FATF Guidance, *supra* note 3, at 5.

assessment and ongoing transaction monitoring. We note further that in many cases, barriers exist even to the sharing of information within the banking organization itself. We appreciate the Committee's acknowledgement of this fact in its Guidelines on the *Sound management of risks related to money laundering and financing of terrorism*, to which the Revisions relate, which note that "implementing group-wide AML/CFT procedures is more challenging than many other risk management processes because some jurisdictions continue to restrict the ability of banks to transmit customer names and balances across national borders."²² The Revisions recognize only in passing that banks' ability to obtain information on a particular transaction "may depend on legal or technical permissibility."²³ Recognition of this point is particularly important for financial institutions – including our members – that operate internationally and provide correspondent banking services to banks in many countries around the globe. We respectfully request that the Committee acknowledge these barriers in the context of correspondent banking in its discussions of risk assessment and ongoing monitoring.

B. The Committee should clarify that the Revisions encourage banks' general understanding of respondent banks' customer bases, rather than knowing more detailed information about those customers.

The term Know-Your-Customer's-Customer ("KYCC") has been the cause of substantial confusion throughout the correspondent banking community. The FATF Guidance devotes a paragraph to clearly establishing that "[t]here is no expectation, intention or requirement for the correspondent institution to conduct customer due diligence on its respondent institution' [sic] customers."²⁴ We appreciate the Committee's consistent approach where it notes that correspondent banks may consider "the respondent bank's major business activities including target markets and *overall* types of customers served in key business lines" and that "the correspondent bank should have a *broad knowledge* of the products and services offered and types of customers served by the respondent bank."²⁵ We also appreciate the Committee's recognition that "nested, or downstream, correspondent banking relationships are an integral and generally legitimate part of correspondent banking." Having acknowledged this important fact, we suggest that the Committee also remove the term "nested" and instead use the term "downstream" throughout the Revisions. The term "nested" has developed negative connotations with respect to AML/CFT—the use of alternative terminology would allow for a meaningful discussion of these integral relationships unclouded by negative preconceptions.

We recognize that the existence of downstream banking relationships is an important consideration in the risk assessment of correspondent relationships, and we fully support the principle that correspondent banks should obtain a general knowledge and broad overview of respondent banks' activities and types of customers. With respect to downstream correspondent banking relationships, the Committee provides that "[c]orrespondent banks should assess the AML/CFT risk associated with customers which are respondent banks with nested relationships

²² Bank for International Settlements, *Guidelines—Sound Management of Risks Related to Money Laundering and Financing of Terrorism* (Feb. 2016) at 13, available at <http://www.bis.org/publ/bcbs275.htm>.

²³ Revisions, *supra* note 2, at 3, fn. 7.

²⁴ FATF Guidance, *supra* note 3, at 4.

²⁵ Revisions, *supra* note 2, at 3, fn. 6 (emphases added).

on an individual case by case basis” and notes that “the level of risk may vary depending on the nature of nested foreign financial institutions served by respondent banks, including size and geographical location, products and services offered, markets and customers served, and the degree of transparency provided by the respondent bank.”²⁶ We agree that a correspondent bank must consider the risk of the categories of customers served by its respondent bank customers, and that the degree to which a respondent bank has downstream banking relationships with banks in high-risk jurisdictions is a risk factor that must be taken into account in a bank’s risk assessment of its correspondent relationships, but we are concerned that some of the Committee’s language could give rise to confusion. We emphasize the fact that, particularly in the context of downstream banking relationships, correspondent banks are necessarily reliant on the AML programs of their respondents, and can realistically evaluate only the respondent’s program for evaluating its downstream respondents, but not the downstream respondents themselves. Given the confusion the KYCC concept has caused, for clarity and for consistency with the FATF Guidance, we suggest that the Committee explicitly acknowledge that there is no KYCC requirement for correspondent banks, including with respect to downstream banking relationships.

C. The Committee should acknowledge that it is appropriate for a bank to terminate or refuse to enter a correspondent banking relationship when the AML/CFT risks associated with a correspondent banking relationship are so high as to be unmanageable.

As The Clearing House noted in its comments in response to the CPMI’s consultative report on correspondent banking (the “**CPMI Letter**”), “[d]ue to regulatory expectations, correspondent banks are incentivized to disengage from correspondent banking relationships where the actual and unquantifiable costs associated with managing the AML/CFT risks of those relationships, outweigh any benefits.”²⁷ The USA PATRIOT Act and the U.S. Department of the Treasury’s (“**Treasury**”) implementing regulations impose significant requirements on U.S. banks with respect to their correspondent banking activities, including:

- Ensuring that services are not being used to indirectly provide banking services to foreign shell banks;²⁸
- Obtaining ownership information for private foreign banks;²⁹
- Applying risk-based due diligence policies, procedures and controls to correspondent accounts maintained for foreign financial institutions;³⁰ and
- Undertaking enhanced due diligence with respect to accounts maintained for high risk foreign banks.³¹

²⁶ *Id.* at 4.

²⁷ CPMI Letter, *supra* note 13.

²⁸ 31 C.F.R. § 1010.630.

²⁹ *Id.*

³⁰ 31 C.F.R. § 1010.610.

³¹ *Id.*

In addition, government authorities, the banking industry and multinational bodies have issued an array of guidance discussing measures financial institutions should properly take to identify, monitor and control the AML/CFT risks associated with foreign correspondent banking.³² Although recent guidance has sought to mitigate the de-risking trend,³³ many of the larger U.S. banks and foreign depository institutions operating in the U.S. have been subject to severe public enforcement measures for AML program-related lapses in conducting their correspondent banking business, including civil money penalties, corrective action programs and, in some cases, criminal settlements. Further, as previously noted, banking regulators may rely on the results of required internal audits in their regulatory examinations. In the current environment, therefore, it is understandable, and indeed prudent, for banks to find in certain cases that the risk of maintaining a correspondent relationship is too great to be managed effectively, and in other cases that the cost of managing the risk in a way that meets regulatory expectations and associated audit criteria is too great to justify maintaining the relationship.

The FATF's Recommendations issued in February 2012 recognize this fact, providing that where banks are unable to comply with CDD requirements, they "should be required not to open the account, commence business relations or perform the transaction; or should be required to terminate the business relationship."³⁴ The FATF reinforced this conclusion in its *Guidance for a Risk-Based Approach* in October 2014, noting that where a bank cannot apply an appropriate level of CDD to match a prospective or existing banking customer's risk profile, the bank should "not enter into the business relationship or [should] terminate the business relationship."³⁵ U.S. regulations requiring due diligence programs for correspondent accounts for foreign financial institutions provide that those programs must include procedures to be followed when a bank cannot perform appropriate due diligence, "including when the covered financial institution should refuse to open the account ... or close the account."³⁶ Similarly, the

³² See, e.g., Federal Financial Institutions Examination Council, *Bank Secrecy Act/Anti-Money Laundering Examination Manual* (Feb. 27, 2015) at 177-180, available at https://www.ffeic.gov/bsa_aml_infobase/pages_manual/manual_print.htm; Wolfsberg Anti-Money Laundering Principles, *supra* note 10; The Clearing House, *Guiding Principles for Anti-Money Laundering Policies and Procedures in Correspondent Banking* (Feb. 2016), available at <https://www.theclearinghouse.org/issues/articles/2016/02/20160216-tch-guiding-principles-for-aml>; FATF Guidance, *supra* note 3; Basel Committee on Banking Supervision, *Customer Due Diligence for Banks* (Oct. 2001), available at <http://www.bis.org/publ/bcbs85.htm>.

³³ See, e.g. U.S. Department of the Treasury and Federal Banking Agencies Joint Fact Sheet on Foreign Correspondent Banking: Approach to BSA/AML and OFAC Sanctions Supervision and Enforcement (Aug. 30, 2016), available at <https://www.treasury.gov/press-center/press-releases/Pages/jl0541.aspx> (attempting to dispel "myths" that: (1) U.S. banks are expected to conduct due diligence on the individual customers of the foreign banks for which they provide correspondent services, i.e., that they must "know" their "customers' customers"; and (2) the BSA/AML and OFAC sanctions enforcement regime is one of "zero tolerance," i.e., one in which any misstep will result in a public enforcement action)

³⁴ Financial Action Task Force, *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations* (Feb. 2012), available at <http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html>.

³⁵ Financial Action Task Force, *Guidance for a Risk-Based Approach: The Banking Sector* (Oct. 2014), available at <http://www.fatf-gafi.org/publications/fatfrecommendations/documents/risk-based-approach-banking-sector.html>.

³⁶ 31 C.F.R. § 1010.610(d).

Guiding Principles note that “if the risks become outside the risk tolerance of the Bank, the Bank may decide to terminate the Bank’s [correspondent] relationship.”³⁷ Thus, for clarity and consistency, we suggest that the Committee expressly acknowledge this important concept.

D. To address de-risking, the Committee should make clear that, if the standards and processes in the Revisions are followed in good faith, banks can be assured they will be found to be in conformity with regulatory requirements.

Banks do not indiscriminately de-risk from jurisdictions. However, they also do not have resources commensurate with those of states, regulatory supervisors and standard-setting bodies to understand the extent of real risks in a given jurisdiction. We support and believe in the effectiveness of a risk-based approach to AML/CFT controls, but note that the approach by its very nature is such that not all AML/CFT activity will be detected. Indeed, as The Clearing House noted in its 2013 letter responding to the Committee’s consultative document on the *Sound Management of Risks Related to Money Laundering and Financing of Terrorism*, “[a] risk-based approach is not intended to catch 100% of all illicit activity—such a system is impossible.”³⁸ In light of this fact, “[s]upervisors should . . . not treat an isolated miss as a reason to call into question the effectiveness of a bank’s entire AML-CFT risk management systems.”³⁹ If banks are to continue to promote financial inclusion and other public policy objectives, as well as provide law enforcement with access to important information regarding possible criminal activity, by providing correspondent banking services to banks in certain higher-risk regions or sectors, they must be assured that their good-faith adherence to existing risk-based principles will protect them from the regulatory and audit risks associated with providing services to banks in those jurisdictions or sectors—precisely the risks that contribute in large part to de-risking decisions.

The Revisions state that correspondent banks should consider the jurisdictions in which the respondent bank and its subsidiaries are located and, “[w]here deficiencies are identified in certain jurisdictions, correspondent banks should also take into account the corrective measures under way to strengthen the jurisdiction’s AML/CFT controls, as well as efforts by domestic authorities to instruct respondent banks on how to strengthen their controls and mitigate ML/FT risks.”⁴⁰ We respectfully submit that, given the risks highlighted in section C of this Part II above, it is simply unrealistic to expect correspondent banks to act as gatekeepers, and therefore *de facto* regulators of the international payment system. Instead, as The Clearing House suggested in the CPMI Letter, we believe that a better approach is to view AML/CFT efforts as a private sector-public sector partnership in which the roles of individual banks and governments

³⁷ Guiding Principles, *supra* note 4, at 13.

³⁸ The Clearing House, Letter to Secretariat of the Basel Committee on Banking Supervision, Re: Comment Letter on Consultative Paper, *Sound Management of Risks Related to Money Laundering and Financing of Terrorism* (Sept. 27, 2013) at 16, available at <https://www.theclearinghouse.org/issues/articles/2013/09/20130927-supporting-international-standards-on-money-laundering>.

³⁹ *Id.*

⁴⁰ Revisions, *supra* note 2, at 6.

are clearly defined.⁴¹ It is the role of correspondent banks to implement risk-based policies that are consistent with regulatory expectations, but it is regulators' and supervisors' roles to develop clear expectations and implement them consistently and predictably. Acknowledgment of correspondent banks' ability to rely on the Revisions' expressed standards and processes would represent a recognition of this important role.

We note that industry and regulators are aligned in their ultimate goal of ensuring the broad provision of international transaction services, and that to achieve this goal requires finding a balance between the benefits of financial inclusion and the burdens imposed by regulatory requirements and enforcement practices. The current de-risking trend suggests that this balance may need to be adjusted. We respectfully submit that explicitly allowing correspondent banks to rely on a good-faith application of the Revisions' expressed standards and processes and providing the related assurances that in doing so banks will be deemed in compliance with regulatory requirements would be a significant step to adjust this balance towards the promotion of financial inclusion.

III. While further development of information-sharing tools may be helpful, a more meaningful approach to reducing due diligence costs is to permit correspondents to more fully rely on the supervision of their respondents and information provided by KYC utilities.

In the Revisions, the Committee asks whether further detail as to the type of information a correspondent bank could acquire from a KYC utility would be useful and, further, whether the particular information the Committee suggests could be useful and realistically obtained.⁴²

We agree with the Committee that there is some efficiency to be gained through KYC utilities and think that the suggested information could be useful in developing a respondent bank's risk profile, subject to the understanding that this would serve as a baseline and that additional jurisdictional and market segment data likely would be needed in order for correspondent banks to fully comply with regulatory requirements. However, we think these tools are unlikely to materially reduce the cost of KYC compliance for correspondent banks, absent a change in regulatory expectations. Because individual banks are currently required to maintain their own systems and programs to detect, prevent and report activity related to AML/CFT concerns, banks are limited in the extent to which they can ultimately benefit from these initiatives. We also note that, as discussed in Part II(A) above, the usefulness of these utilities may be further restricted by jurisdiction-specific privacy and bank secrecy laws, which may prevent the sharing of information from an originating bank to a receiving bank. Further, respondent banks are not always willing to share certain information, such as data on downstream banking activity, including through KYC utilities.

The Committee also suggests that “[t]o the extent improvements in the content of payment messages allow this, such as with the inclusion of ISO [(“**International Organization for Standardization**”)] country codes and the LEI [(“**Legal Entity Identifier**”)], some of this information can be obtained and updated through analysis of the flow of messages of the

⁴¹ CPMI Letter, *supra* note 13, at 6.

⁴² Revisions, *supra* note 2, at 5-6.

respondent bank, as this will provide information on the customers using correspondent banking services.”⁴³ We note that this function is not yet available, and that such analysis and updating would only be possible if KYC utilities have direct access to payment message information. Further, to the extent the language is suggesting that banks actively play a role in the updating of information through an analysis of message flows, we submit that such an expectation would be operationally difficult to perform as a due diligence step. Given these factors, this information cannot currently be realistically obtained, and we therefore respectfully request that the Committee strike this language from the Revisions.

The Revisions further state that “the ultimate responsibility for CDD remains with the bank.”⁴⁴ While we acknowledge the need for robust CDD, we also submit that KYC utilities add no value to correspondent banks’ CDD processes if the utilities’ use is not acknowledged by regulators and given some weight in compliance determinations. Absent regulatory backing for the KYC utility, correspondent banks remain internally responsible for managing potentially incomplete data and performing risk assessments—no part of the CDD process is removed or simplified. Thus, to realize any significant impact on CDD costs and efficiency, regulators will need to recognize banks’ use of KYC utilities as a valid piece of AML/CFT compliance programs.

Because of the limitations on the usefulness of KYC utilities, we suggest that a more effective way to reduce CDD costs would be to permit banks to rely on international determinations of the quality of a respondent bank’s home country supervision, such as the FATF’s regular identification of high-risk and non-cooperative jurisdictions.⁴⁵ The Financial Stability Board notes that “[t]he more local authorities build trust in their AML/CFT frameworks and in the quality of their supervision, the more foreign correspondent banks will be able to rely on the information they provide without multiplying costly due diligence and checks.”⁴⁶ We submit that the Committee and other international standard-setting bodies can play a significant role in this process by developing a public consensus as to the strength of jurisdictions’ AML regimes on which correspondent banks can rely. Government and regulatory recognition of the quality of home country supervision—provided that this recognition is also incorporated into supervisory practice—would promote efficiency in correspondent banks’ CDD processes and significantly decrease associated costs.

IV. Banks’ monitoring and reporting obligations with respect to “manifestly meaningless or incomplete fields” in payment messages must be clarified.

The Committee asks whether it would be useful to insert into the Revisions the content related to the role of supervisors from the Committee’s publication *Due diligence and transparency regarding cover payment messages related to cross-border wire transfers* (the

⁴³ *Id.*

⁴⁴ *Id.* at 12.

⁴⁵ See FATF, *Topic: High-Risk and Non-Cooperative Jurisdictions*, [http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/?hf=10&b=0&s=desc\(fatf_releasedate\)](http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/?hf=10&b=0&s=desc(fatf_releasedate)).

⁴⁶ Financial Stability Board, *FSB Action Plan to Assess and Address the Decline in Correspondent Banking—End-2016 Progress Report and Next Steps* (Dec. 2016), available at <http://www.fsb.org/2016/12/fsb-action-plan-to-assess-and-address-the-decline-in-correspondent-banking/>.

“**2009 Publication**”). We believe that it would be useful to insert the referenced paragraphs from the 2009 Publication into the Revisions in order to more thoroughly address the supervisory role with respect to payment messages in the correspondent banking context. While we recognize that banks should strongly encourage their correspondent banking customers to adhere to payment message transparency standards such as those developed by The Clearing House and the Wolfsberg Group in 2007 and the SWIFT MT 202 COV standards, we believe that it is not the role of intermediary banks to determine whether their respondents are in compliance with such standards. The Guiding Principles note that “it is the responsibility of the originator’s bank to include complete and accurate information in the payment orders it sends to the intermediary and beneficiary’s bank.”⁴⁷ Therefore, enforcement of public and private sector expectations for payment messages, including the provision of complete and meaningful information, should focus on originators’ banks and those banks’ regulators. As the Committee noted in the 2009 Publication, “supervisors must be satisfied that banks develop and implement appropriate policies, procedures and processes in their respective capacities as originator banks, intermediary banks . . . and beneficiary banks.”⁴⁸ Supervisors should determine “whether the institution has implemented the transparency standards and maintains systems for consistent adherence to the transparency standards.”⁴⁹ As The Clearing House and the Wolfsberg Group noted in their comments to the Committee regarding the 2009 Publication, “[u]nless home country regulators of originators’ banks require and promote compliance with the enhanced transparency standards, there is little that cover intermediary banks . . . can do to ensure transparency and accuracy” in payment messages.⁵⁰ Correspondent banks should not be required to act as *de facto* regulators—such requirements serve only to increase regulatory compliance costs and exacerbate the de-risking phenomenon.⁵¹

The Committee also requests suggestions for detailing further the expectations with respect to monitoring the quality of payment messages.⁵² The Committee states that “intermediary banks should monitor payment messages for manifestly meaningless or incomplete fields,” and that “the quality of information provided in payment messages should be part of the ongoing monitoring.”⁵³ We submit that any requirement for real-time or post-transaction monitoring by intermediary banks of originator and beneficiary fields for meaningfulness (beyond what is required to complete the processing of the payment) would be ineffective and ultimately counterproductive. Payment data monitoring systems for AML/CFT purposes are not designed to review specific payment fields to determine whether the information contained therein is meaningful or complete; rather, they are designed to look for specific information in those fields. The Clearing House Association and the Wolfsberg Group

⁴⁷ *Id.*

⁴⁸ 2009 Publication, *supra* note 47, at 11.

⁴⁹ *Id.*

⁵⁰ The Clearing House & the Wolfsberg Group, Letter to Basel Committee on Banking Supervision, *Re: Consultative Paper on Due Diligence and Transparency Regarding Cover Payment Messages Related to Cross-Border Wire Transfers* (Sept. 12, 2008).

⁵¹ *See* CPMI Letter, *supra* note 13, at 3.

⁵² Revisions, *supra* note 2, at 8.

⁵³ *Id.*

put substantial effort into the development of the MT 202COV message format for third-party cover payments, which, as the Committee recognized, enhances banks' risk management processes by improving transparency in cross-border payments.⁵⁴ The MT 202COV addresses transparency concerns by allowing intermediary banks to monitor and filter the appropriate fields, while still allowing straight-through processing. Because any substantive analysis of the content of payment messages must be manual, a requirement to monitor for meaningless or incomplete fields would be inconsistent with straight-through processing and would add significant costs to correspondent banks' payment processing systems. Any real-time review in this manner would also create significant processing delays.

Even if manual review were otherwise feasible, because they lack access to full information, it is impossible for intermediary banks to determine when information provided in payment messages is "manifestly meaningless" or incomplete—they lack the informational context necessary to do so. Further, the determination of whether information is meaningful is a subjective one, and is highly dependent on the knowledge of the reviewer and local conventions for addresses and names. Originators' banks initiate the cross-border payment messaging process and have the greatest opportunity to assess potential customers and monitor their ongoing payment activity. Thus, as noted in the Guiding Principles, it is "not practicable to require the intermediary banks to conduct due diligence on, or even identify, the customers of the originator's and beneficiary's banks."⁵⁵ As discussed in Part III above, functionalities do not yet exist to enable banks to obtain updated information on a respondent bank's customers based on an analysis of payment flows—even where payment messages include ISO country codes, the LEI, or other information—and any expectation that they do so as a part of their regular due diligence with respect to their correspondent relationships is simply unrealistic and is beyond the scope of clearly stated regulatory and supervisory expectations.

Finally, given the inherent limitations on correspondent banks' ability to monitor the content of payment messages, we suggest that the Committee also take the opportunity to expressly acknowledge, as discussed in Part II(D) above, the fact that a risk-based approach—in which 100% success is impossible—is also the supervisory expectation with respect to payment message transparency and monitoring. We appreciate the Committee's implicit recognition of the risk-based approach when it suggests that correspondent banks may monitor payment messages via sample testing—a risk-based, post-transaction review practice utilized by many institutions that identifies prior misses to improve the transparency of future messages.⁵⁶ However, we believe that the Committee's express acknowledgement that supervisory expectations with respect to payment message monitoring remain consistent with a risk-based AML/CFT program would help to prevent de-risking in response to unrealistic and overly demanding monitoring expectations. Post-transaction review practices such as sample testing are the best way for banks to monitor payment messages, as they are fully consistent with a risk-based approach and are practically feasible for banks to implement.

⁵⁴ Bank for International Settlements, *Due Diligence and Transparency Regarding Cover Payment Messages Related to Cross-border Wire Transfers* (May 2009) at 2, available at <http://www.bis.org/publ/bcbs154.htm>.

⁵⁵ Guiding Principles, *supra* note 4, at 7.

⁵⁶ Revisions, *supra* note 2, at 8.

V. Conclusion

The Associations appreciate the Committee's work to provide clarity to correspondent banks regarding AML/CFT requirements by revising Annexes 2 and 4 of the guidelines on the *Sound management of risks related to money laundering and financing of terrorism*. We also recognize and share the Committee's interest in mitigating and reversing the de-risking trend. In this regard, we have highlighted certain instances in which we believe the Revisions could go further in clarifying the principles and standards for risk management and responsibilities for ongoing monitoring. Underlying each of our suggestions is a request for recognition that these principles and standards are to be applied within the overall framework of a risk-based approach to AML/CFT compliance. This recognition, at both the international and supervisory levels, is an essential aspect of any strategy to combat de-risking.

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The Associations would welcome the opportunity to provide any additional assistance or input. If you have any questions, please do not hesitate to contact Angelena Bradfield by phone at 202-649-4608 or by email at angelena.bradfield@theclearinghouse.org.

Respectfully submitted,



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ANNEX A

The Clearing House. The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Association L.L.C. is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system. Its affiliate, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by building a new, ubiquitous, real-time payment system. The Payments Company is the only private-sector ACH and wire operator in the United States, clearing and settling nearly \$2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume.

The Institute of International Bankers. IIB is the only national association devoted exclusively to representing and advancing the interests of the international banking community in the United States. Its membership is comprised of internationally headquartered banking and financial institutions from over 35 countries around the world doing business in the United States. The IIB's mission is to help resolve the many special legislative, regulatory, tax and compliance issues confronting internationally headquartered institutions that engage in banking, securities and other financial activities in the United States. Through its advocacy efforts the IIB seeks results that are consistent with the U.S. policy of national treatment and appropriately limit the extraterritorial application of U.S. laws to the global operations of its member institutions. Further information is available at www.iib.org.