

25 August 2016

Progress report to G20 on the FSB action plan to assess and address the decline in correspondent banking

The Financial Stability Board (FSB) presented to G20 Leaders in November 2015 an action plan to assess and address the decline in correspondent banking,¹ with four elements:

- Further examining the dimensions and implications of the issue;
- Clarifying regulatory expectations, as a matter of priority, including more guidance by the Financial Action Task Force (FATF);
- Domestic capacity-building in jurisdictions that are home to affected respondent banks;
- Strengthening tools for due diligence by correspondent banks.

A decline in the number of correspondent banking relationships is a source of concern for the international community because it may affect the ability to send and receive international payments, or drive some payment flows underground, with potential consequences on growth, financial inclusion, as well as the stability and integrity of the financial system.

The FSB established in March 2016 the Correspondent Banking Coordination Group (CBCG) to coordinate and maintain impetus in the implementation of the action plan. The CBCG's membership comprises senior representatives from international organisations and standard setters and national authorities in the FSB and its Regional Consultative Groups. This report describes progress under each of the four elements of the action plan. A more comprehensive report on progress will be published by end-2016. Work will continue in 2017 to address these issues, including continuing to monitor changes in correspondent banking to assess whether the plan is having the intended impact.

The CBCG and its members have made substantial progress towards implementing the FSB action plan:

- Following consultation, the Committee on Payments and Market Infrastructures (CPMI) has published in July 2016 the final version of its report on correspondent

¹ <http://www.fsb.org/2015/11/report-to-the-g20-on-actions-taken-to-assess-and-address-the-decline-in-correspondent-banking/>
6 November 2015.

banking, with recommendations relating to (i) know-your-customer (KYC) utilities; (ii) use of the Legal Entity Identifier (LEI) in correspondent banking; (iii) information-sharing initiatives; (iv) payment messages; and (v) use of the LEI as additional information in payment messages.²

- The CPMI report includes an analysis using an extensive SWIFT data set. These data show that in recent years, although overall transaction volumes in correspondent banking have grown, the number of active correspondents has decreased across most regions, which suggests that there has been increased concentration in correspondent banking relationships.
- An International Monetary Fund (IMF) staff discussion note further discusses the evidence of a withdrawal in correspondent banking relationships and actions needed to address the issue.³
- CBCG has designed a survey to address remaining data gaps, including the effects of the decline on specific categories of customers and the extent of the concentration of correspondent banking in specific markets;
- CBCG has proposed areas where regulatory expectations should be clarified; the FATF has made substantial progress towards issuing in October 2016 guidance on the application of its standards to correspondent banking, to be followed by further clarification by the Basel Committee on Banking Supervision (BCBS) of its own existing guidance;
- CBCG is assisting in the coordination of resources available to address technical assistance needs to support affected jurisdictions in conducting risk assessments and developing effective anti-money laundering and countering the financing of terrorism (AML/CFT) frameworks; CBCG is also encouraging private sector initiatives and supporting dialogue between the public and private sectors, for instance with roundtables and other events organised by FSB Regional Consultative Groups and the IMF and the World Bank.

1. Data collection and analysis to further examine the dimensions and implications of the issue

The action plan stated that the FSB would continue to encourage the collection of relevant information by the World Bank and other international organisations on the scale of withdrawal, its causes and effects and that national authorities should also improve their own data collection.

The FSB has designed a one-off survey of national authorities and banks that will be used to collect additional information, and is also discussing how to collect a simpler set of data regularly to monitor future trends.

² <http://www.bis.org/cpmi/publ/d147.htm>

³ <http://www.imf.org/external/pubs/ft/sdn/2016/sdn1606.pdf>

1.1 Findings by the CPMI

The CPMI report on correspondent banking published in July 2016 provides global and regional statistics as well as, country by country, the percentage change in the number of correspondents, as well as the volume and value of transfers between 2012 and 2015. These results are based on monthly transaction data, provided by SWIFT on an exceptional basis. The number of corridors (or country pairs) showing payment activity represent about one quarter of the theoretical number of corridors, with a slight decline from roughly 13,000 in 2011 to 12,600 corridors in 2015 and there is a clear downward trend in the number of active correspondents across regions, although overall volumes of payments increased from 2011 to 2015. This suggests that there has been an increased concentration in correspondent banking relationships. The CPMI report also notes that the increase in overall volumes of transfers may still be consistent with reports of a decline in the number of correspondent banking relationships, since payments are most likely switched to other channels after account closures and, if the payments are rerouted through third countries, this rerouting could even lead to an increase in the volume correspondent banking transfers.

When looking at worldwide aggregated data only, the dominance of high-traffic corridors might mask developments within other corridors and even entire regions with less significant activity. Indeed, developments differ substantially across countries and regions. While the number of active correspondents⁴ declined between 2012 and 2015 in over 120 countries out of the 204 for which the CPMI has published data, it increased elsewhere, sometimes substantially, and the decline exceeds 10% for some 40 countries.

The regional results from the CPMI analysis generally confirm, but refine, the findings from the 2015 World Bank survey. The most pronounced absolute decline in active correspondents has occurred in European regions. For African regions, the CPMI notes that the picture is mixed, with pronounced declines in Northern Africa and partly in Southern Africa, but substantial increases in other regions. The Americas saw significant declines in the number of correspondents with the exception of Central America. Asian regions experienced declines in 2012, but mostly increasing numbers thereafter.

1.2 Additional data needs

The FSB has identified through the work of the CBCG some areas where additional data and information is necessary to assess the scale of withdrawal from correspondent banking, its causes and effects and support policy work:

- (i) A deeper analysis of the causes and consequences of the decline, for instance looking in more details at the knock-on effect of the reduction in correspondent banking on specific categories of customers, or the development of alternative channels to correspondent banking.
- (ii) Concentration of correspondent banking in specific markets: the potential impact of a decline in the number of active correspondents in a given country on the cost of transfers and on financial stability risks is likely to depend on whether there exists significant

⁴ “Active correspondents” in a country are measured as the sum of the number of correspondents active in each corridor, i.e. correspondents active in more than one corridor are counted several times.

concentration in the number of correspondent banks serving that country, and in the number of local banks having access to correspondent banking services. For instance, the IMF Staff Discussion Note of June 2016⁵ observes that “*The limited number of banks operating in small Pacific states amplifies the risk and impact of the loss of correspondent banking relationships*”. The IMF also observes that in the Caribbean region “*At least 16 banks in the region across five countries have lost all or some of their CBRs as of May 2016*”. Therefore, it could be useful to have, on a country by country basis, a measure of concentration on both the correspondent and the respondent side, as well as the proportion of banks that rely on a single correspondent for a significant part of their activity. CPMI data shows that the proportion of corridors with less than 10 active banks does not seem to have changed significantly (p. 49) but this does not provide a heat map of individual countries exposed to a significant concentration risk.

- (iii) Changes in the structure of correspondent banking. The World Bank wrote⁶ that “*it is not quite clear to what extent the local/regional banks whose relationships are being withdrawn are finding second and third-tier banks to meet their needs for foreign correspondent banking relationships and the further effect on overall transparency*”. A Caribbean Association of Banks survey shows for instance that at least one of their members has a correspondent banking relationship with a bank in the Indian Ocean. Therefore, it could be helpful to measure the evolution in the proportion of banks that rely on smaller correspondents, or that rely on correspondents that are not in the same group, same country, or in the country of the currency being processed.

1.3 Process for the data collection

To address the data gaps described above, the CBCG has designed a survey that will be used to collect data from national authorities and banks, with the assistance of FSB member jurisdictions, members of FSB Regional Consultative Groups and a sample of other jurisdictions that appear to have been affected by a decline in correspondent banking. Preliminary results (to the extent already available) will be presented in the overall FSB progress report to be published by the end of the year.

2. Clarifying regulatory expectations

The action plan includes the clarification of regulatory expectations, including more guidance by the FATF in the area of correspondent banking, in cooperation with the BCBS AML/CFT Expert Group. This will support common understandings amongst relevant agencies, supervisory staff and banks, both nationally and internationally.

The CBCG developed a list of potential areas for further clarification based on a review of ongoing FATF work, existing BCBS papers and the CPMI consultative report on correspondent

⁵ <http://www.imf.org/external/pubs/ft/sdn/2016/sdn1606.pdf> p. 15.

⁶ Withdrawal from correspondent banking: where, why and what to do about it, the World Bank, November 2015, p. 40 <http://documents.worldbank.org/curated/en/113021467990964789/pdf/101098-revised-PUBLIC-CBR-Report-November-2015.pdf>.

banking, requests for clarifications from various public sector and industry sources, as well as interactions with industry at the FATF Private Sector Consultative Forum on 20 April 2016:

- The definition of correspondent banking, identification of risk buckets within correspondent banking and the implementation of the risk-based approach in the area of correspondent banking.
- The due diligence to be conducted on the respondent bank, including the method for gathering and updating information on respondent banks and regulatory expectations concerning the verification of such information;
- Nesting, or “downstream clearing”, which is the situation where the services of the correspondent bank are used by the respondent bank to provide correspondent services to other banks. The issue here is whether regulatory expectations can be clarified on how to mitigate the risks associated with the indirect relationships created by nesting, while preserving this necessary feature of correspondent banking;
- The absence in the FATF standards of a requirement for correspondent institutions to conduct due diligence on the customers of the respondent banks, (“know your customer’s customer” or KYCC). Both the private and public sector agree that the term KYCC is misleading to describe requests for information on any particular transaction(s) as a part of ongoing monitoring, which may lead to more information being requested on a specific customer or customers of the respondent institution;
- The role of authorities in building trust in the quality of local supervision of respondents and in demonstrating that problems are detected and addressed;
- The termination of correspondent banking relationships, the related governance processes and possible encouragement of dialogue and escalation of due diligence before termination takes place and of various approaches to address the fact that the time needed to open a new correspondent banking relationship frequently exceeds the duration of termination notices.

These areas were, or will be, considered for potential clarification by FATF and/or BCBS as appropriate.

The FATF discussed a revised draft of its correspondent banking guidance at its 20-24 June 2016 meeting, organised a consultation of the private sector in July/August 2016 and will finalise the guidance at the next FATF Plenary meeting in October 2016. The consultation of the private sector sought views on the potential benefits or drawbacks of a revision of FATF’s definition of correspondent banking to help address some of the “de-risking” challenges. It is important that, by the October 2016 FATF Plenary, FATF complete its work on correspondent banking guidance, so that the implementation of these clarifications in sectoral guidance by the BCBS as well as national implementation in domestic guidance can proceed swiftly thereafter. Additionally, the FATF will discuss a potential revision of the definition of correspondent banking at its October Plenary meeting.

BCBS will in parallel work on further clarification of its own existing guidance (including in areas such as use of KYC facilities and payment message quality), to complement and provide input to FATF’s ongoing work, but will finalise its own contribution, for public consultation, only after the conclusion of FATF work to ensure it is fully aligned. Therefore, BCBS work is expected to conclude early in the German G20 Presidency.

The CBCG also discussed the potential role of uncertainty over regulatory expectations concerning economic sanction regimes in the decline in correspondent banking. Relevant national authorities are encouraged to issue guidance, or continue to issue guidance, on their national or regional sanction regimes, and engage with interested parties, to support clarity in the implementation of these sanction regimes in correspondent banking.

The FATF also updated its guidance in two areas particularly exposed to the consequences of the decline in correspondent banking. The FATF published:

- in February 2016 its guidance for a risk-based approach for money or value transfer services⁷; and
- in June 2016 the revision of FATF Recommendation 8 on non-profit organisations and its interpretive note to protect non-profit organisations from terrorist financing abuse. The revised standard, prepared after a consultation and dialogue meeting in April 2016 and two rounds of public consultations, seeks to ensure that the implementation of Recommendation 8 is in line with the risk-based approach and does not disrupt or discourage legitimate non-profit activities.

3. Domestic capacity-building in jurisdictions that are home to affected respondent banks

The FSB report of 6 November 2015 observed that jurisdictions most frequently exited by large global correspondent banks seem to be those with weak supervisory and regulatory frameworks, including those with weaknesses related to AML/CFT and those which are subject to United Nations sanctions. It is therefore essential to support jurisdictions in conducting risk assessments and developing effective AML/CFT frameworks, as well detecting and addressing deficiencies before these result in a reduced access to the global financial system.

3.1 Assessment of weaknesses and technical assistance (TA)

Under the action plan, “International financial institutions, the FATF and FATF-style regional bodies will, through assessments and technical assistance, support jurisdictions in identifying and addressing their weaknesses in AML/CFT compliance, as well as conducting risk assessments and developing AML/CFT frameworks.”

The CBCG established an inventory that identifies official sector TA and other capacity-building activities, at this stage mainly covering those provided by IMF, World Bank, European Bank for Reconstruction and Development (EBRD), Inter-American Development Bank (IDB), US Office of the Comptroller of the Currency and US Treasury. This inventory will be augmented further by information from other national authorities and international organizations. The inventory compares this information with the jurisdictions identified through the 2015 World Bank Survey or publicly available information as having experienced a decline in correspondent banking. Country data from the CPMI report and the survey to be conducted by CBCG will be added. The CBCG is also collecting additional information from other providers, such as the FATF Global Network Coordination Group and FATF-style regional

⁷ <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-RBA-money-value-transfer-services.pdf>

bodies. It has collated a list of public reports on countries potentially affected by a decline in correspondent banking from various sources, including Financial Sector Assessment Program reports (FSAPs), IMF Article IV consultation reports and Office of the Comptroller of the Currency, which may indicate potential TA needs in the future.

The objective is to:

- Support further coordination between national and multilateral TA, including strengthening existing informal communication channels between TA providers (e.g. bilateral dialogues), to avoid duplication;
- Identify any excess of demand over supply of resources for TA, so that the FSB can consider whether to recommend increased resources for this purpose. For instance, the FSB emphasised the importance of sufficient financial and staff resources being available at the IMF and World Bank to address AML/CFT capacity-building needs of jurisdictions experiencing a decline in correspondent banking. This would assist in meeting the call in the G20 Communiqué of July 2016 for G20 members, the IMF and World Bank to intensify their support for domestic capacity building to help countries improve their compliance with global AML/CFT and prudential standards.

3.2 Encourage training or assistance provided by private sector initiatives

3.2.1 Private sector initiatives

The FSB action plan recommended that, building on the proposals and regulatory expectations from relevant authorities and standard setting bodies, the financial industry should discuss how correspondent banks can work with respondent banks to support improvements in processes at respondent banks and organise information sharing on banks and customers.

In addition to the industry actions recommended by CPMI described in section 4 below, correspondent banks can support improvements at respondent banks, notably as to what measures respondents could proactively undertake in order to avoid account closures. The CBCG has discussed how industry bodies could complement and enhance public sector capacity building initiatives, by promoting those of the private sector directed at improving correspondent banking due diligence and compliance practices. The Wolfsberg Group⁸ of international banks has indicated that it would coordinate the collection of information as to the existing (and possibly future) capacity building activities undertaken by its members and present them in a consolidated manner to be included in the CBCG's final report. The Group has also noted that it will seek to foster other activities as part of a collective effort from both the public and private sectors in the area of capacity building (e.g. subject matter expertise input to TA activities of the public sector, providing relevant training material).

3.2.2 Dialogue between the public and private sector

The FSB committed to facilitate dialogue among banks and authorities, to share their experiences and explore solutions that can help improve compliance with standards related to AML/CFT and implementation of international economic sanctions, risk assessment or the

⁸ <http://www.wolfsberg-principles.com/>

development of information sharing, including through organising regional workshops in collaboration with the IMF and World Bank.

Members of the FSB and CBCG are actively supporting dialogue through a range of events, including:

- Follow-up events to the high-level workshops organised together with the IMF and World Bank in 2015, at the IMF/World Bank Spring and Annual Meetings and with the FSB Regional Consultative Groups in the Middle East & North Africa region, in Sub-Saharan Africa and the Americas. Follow-up events are being organised by FSB Regional Consultative Groups in these regions in 2016, including a roundtable with industry in Montreal held on 27 May 2016.
- The World Bank organised with the Association of Certified Anti-Money Laundering Specialists (ACAMS) a Stakeholder Dialogue on De-risking on 31 May and 1 June in Washington.
- The FATF dedicated one day of its annual Private Sector Consultative Forum to correspondent banking issues in April 2016 and consulted the private sector on the draft Guidance in July/August 2016.
- The US authorities and the IMF (together with the Union of Arab Banks), organised a banking dialogue conference for the Middle East & North Africa region in April 2016 in Washington DC.
- The US authorities organised a series of bilateral and regional events.

3.2.3 Developing proposals on actions national authorities can take to build trust in their AML/CFT frameworks and quality of supervision.

The CBCG is examining means to strengthen information sharing, including sharing non-country-specific lessons from capacity-building activities and relevant information from surveillance tools such as IMF FSAP and Article IV consultation reports in order to deepen understanding of issues, capacity-building needs and help to understand the causes and effects of the decline in correspondent banking.

The IMF Staff Discussion Note of 30 June 2016 provides examples of national authorities' efforts in addressing the withdrawal of correspondent banking relationships by strengthening their AML/CFT framework, improving banking supervision, developing domestic inter-agency cooperation or cross-border information sharing and other actions⁹. The survey described in section 1 may provide further examples of actions and lessons learnt.

4. Strengthening tools for due diligence by correspondent banks

CPMI has published its finalised report on correspondent banking. Recommendations were enhanced and expanded. As noted in the CPMI report and described below, the implementation of the recommendations will require ongoing cooperation by a number of public sector and private sector bodies. In addition to the CPMI recommendations, other technical solutions

⁹ <http://www.imf.org/external/pubs/ft/sdn/2016/sdn1606.pdf>, for instance box 9 p. 31 on Colombia, Mexico, the Bahamas and West Bank and Gaza.

addressing or offsetting the reduced availability of correspondent banking are also being discussed by CBCG.

4.1 Summary of CPMI recommendations and next steps

4.1.1 Recommendation on the use of “know your customer” (KYC) utilities:

The CPMI identifies two further steps to be taken:

- Standardising information and data in KYC utilities, with a view to making these utilities more effective in reducing the customer due diligence costs associated with correspondent banking. CPMI will reach out to the International Organization for Standardization (ISO) to examine if they could define a standardised minimum set of information and data (including the format) that all utilities should collect and that all banks must be ready to provide to other banks which require the information and data.
- Clarifying regulatory expectations concerning the use of KYC utilities: The BCBS has started discussing the development of a set of issues that financial institutions should consider when using KYC utilities, to support an appropriate use of these utilities.

4.1.2 Recommendation on the use of the Legal Entity Identifier (LEI) in correspondent banking:

Implementation measures include:

- General promotion of LEIs for legal entities: at its March 2016 Plenary meeting, the FSB had a preliminary discussion of ways to promote expanded use of the Legal Entity Identifier. The LEI Regulatory Oversight Committee¹⁰ (LEI ROC) has also established a workstream on LEI expansion to support the same objective.
- Mapping the LEI with other identifiers: Promoting BIC-to-LEI mapping facilities, would allow for routing information available in the payment message to be mapped to the relevant LEI. CPMI, in cooperation with CBCG will organise a joint workshop in order to understand existing solutions and identify potential ways of promoting BIC-to-LEI mapping facilities.
- Assessing potential uses of the LEI as a means of accessing reliable information to support customer due diligence in correspondent banking. The BCBS has already encouraged the use of the LEI in some circumstances in its *General guide to account opening*¹¹ and is considering other potential uses of the LEI specifically for correspondent banking. For example, the LEI ROC published on 10 March 2016 its final report on *Collecting data on direct and ultimate parents of legal entities in the Global LEI System – Phase I*¹², and this data might support some due diligence by correspondent banks on their respondent banks. Ongoing work by the LEI ROC, GLEIF and Local Operating Units of the LEI system to enhance the scope,

¹⁰ <http://www.leiroc.org/>

¹¹ <http://www.bis.org/bcbs/publ/d353.htm>, Annex 4

standardisation and quality of data in the LEI system will also support LEI uses in this area.

4.1.3 Recommendation on information-sharing initiatives:

The CPMI notes that privacy laws may prevent the transmission of additional information by the respondent to its correspondent concerning the transactions, their originators and beneficiaries. Also the private sector identified this as a key issue that may lead banks to avoid high risk customers altogether, as banks may be prevented from sharing information that would clear suspicions, or that would show that suspicions are appropriately handled and reported.

The CPMI identified the following actions:

- “Further explore ways to tackle obstacles to information-sharing, with the aim of identifying potential best practices (in the enterprise-wide context, among financial institutions not part of the same financial group, and between the public and the private sector).” The FATF already initiated a dialogue with the private sector on this issue in April 2016¹³ and published in June 2016 a consolidation of FATF standards on information sharing to support further work in this area. In addition, the FATF is developing best practices to facilitate information-sharing.
- “the use of information-sharing mechanisms (if they exist in a given jurisdiction and data privacy laws allow this) [...] which could be complemented bilaterally with enhanced information should there be a need.” The CPMI report describes the experience in Mexico, and factors to consider when developing such mechanisms.
- “In order to support information-sharing in general, the respondent bank may include provisions in its contractual framework with its customers (e.g. in the terms and conditions or in a supplementary agreement) which allow the bank to provide such general information on request to other banks for AML/CFT compliance purposes.”

4.1.4 Recommendation on payment messages, with a focus on the correct use of available methods for payment.

Two actions are taken to improve the quality of information in payment messages, which should reduce the number of requests for additional information and associated costs, and more generally improve trust between correspondent and respondent:

- CPMI is liaising with relevant stakeholders (the Wolfsberg Group and the Payments Market Practice Group¹⁴ (PMPG)) to follow up on its invitation to review their principles governing the use-cases for payment messages, such as the PMPG’s market practice guidelines and white papers.
- BCBS is developing guidance on supervisors’ role in ensuring that banks meet FATF Recommendations and guidance on the quality of payment message content.

In addition, CBCG discussed several industry actions that will support enhanced payment message quality, such as SWIFT’s upcoming implementation, by 2020, of more structured

¹³ <http://www.fatf-gafi.org/publications/fatfrecommendations/documents/private-sector-apr-2016.html>

¹⁴ <https://www.swift.com/about-us/community/swift-advisory-groups/payments-market-practice-group>

information in payment message fields relating to the ordering customer and beneficiary of wire transfers, or a new commercial product developed by SWIFT for its bank users (“Payments Data Quality service”), being piloted this year, that could be used by SWIFT users to monitor their progress, and the progress of their counterparties, in achieving better quality information in messages.

4.1.5 Recommendation on the use of the LEI on an optional basis as additional information in payment messages:

The CPMI invited relevant stakeholders (e.g. the PMPG) to work to define a common market practice for how to include on an optional basis the LEI in the current relevant payment messages without changing the current message structure.

As part of a potential future migration to message formats based on the ISO 20022 standard, CPMI encourages relevant stakeholders (i.e. ISO and SWIFT) to consider developing dedicated codes or data items for the inclusion of the LEI in payment messages.

The CBCG noted the possibility that adding the LEI may reduce the number of requests for additional information by correspondent to their respondents.

4.1.6 Potential public sector involvement in other technical solutions

The CBCG had initial discussions on the scope for public sector actions, at the national, regional or international level, to support technical solutions addressing or offsetting the reduced availability of correspondent banking. To support further discussions, the IMF Staff Discussion Note of 30 June 2016 presents the case for contingency planning and public support for countries facing severe loss of correspondent banking services, including central banks or publicly-backed vehicles providing, as a last resort, clearing services to banks that find it difficult to secure correspondent banking relationships.

IMF Staff recommends that contingency planning include: “(i) enhanced communication with home authorities and global banks to understand the nature of their risk management concerns, (ii) developing thorough understanding of domestic financial systems’ linkages with correspondent banks and alternative payment arrangements, which could involve non-banks in retail payments and the provision of cross payment services (CPMI 2014), (iii) mapping the necessary legal and regulatory changes to facilitate compliance with relevant international standards, and (iv) carefully assessing the benefits, costs, and risks of developing or using public entities or centralized payment systems to address a complete loss of correspondent banking relationships”.¹⁵ Concerning the latter aspect, CBCG members noted, like IMF Staff, that it was particularly important that concerns about weak compliance with AML/CFT standard be addressed in the first place, as otherwise any public sector facility would face the same problems in accessing the international financial system.

¹⁵ <http://www.imf.org/external/pubs/ft/sdn/2016/sdn1606.pdf> page 33.