

Bank for International Settlements (BIS)
Centralbahnplatz 2
4051 Basel
Switzerland

7 December 2015

Subject: ICC Response to CPMI Report on Correspondent Banking

Dear Sirs,

The International Chamber of Commerce Banking Commission welcomes the publication in October 2015, of the Committee on Payments and Market Infrastructures (CPMI) Consultative Report on Correspondent Banking.

It has been a matter of concern for the Banking Commission and for our National Committees and Member Banks in 90+ countries, that regulatory and market pressures have combined to generate unwelcome, adverse impacts upon the global network of correspondent banking relationships critical to enabling the conduct of cross-border business, investment and trade through an established, effective ecosystem of partnerships, services and financial flows.

The ICC Banking Commission has been working to prepare an articulation of the major issues, partly in response to a mandate from the WTO Experts Group meeting in Geneva earlier this year, and partly as an outcome of the B20/G20 Consultation Session organized at the Banking Commission Meeting in Singapore in April of 2015.

The banking industry has sought in the post-crisis environment, to balance the clear imperative to contribute actively to the strengthening of a global regulatory regime across financial services, while responding to public sector direction for greater support of small and medium-sized enterprises as well as emerging and developing markets. At the same time, the sector aspires to rebuild public trust, ensuring the implementation of stringent risk management disciplines while continuing to create economic and shareholder value through commercial activity.

These dynamics, together with sometimes conflicting objectives have led certain financial institutions to seek to reduce the overall risk profile of their portfolios by exiting markets, correspondent relationships and corporate/commercial relationships, at varying rates and with varying degrees of scope and breadth. Numerous regulatory requirements, from anti-money laundering and counter-terrorism finance, to due diligence ("Know your Customer" and "Know your Customer's Customer") combine to put significant pressure on financial institutions around various forms of risk, including reputational risk.

This process of rationalization of markets and relationships as a means of reducing risk, now commonly referred to as 'de-risking' activity, began several years ago and is ongoing for

some institutions, largely complete for others. While global banks sometimes argue that de-risking is leading to a loss of global capacity, it has also been positioned by other institutions – particularly certain regional banks – as an opportunity to step in and fill market gaps created by the exit of global institutions. The local/regional banks argue that they are able to do so, on the basis of proximity to and greater knowledge of the risk profile of these client groups.

Section 2.2 of the CPMI Consultative Report provides a useful overview of certain notable developments in correspondent banking, listing a series of drivers and considerations that underpin de-risking activity from the banking industry's perspective, including concerns about particular markets, currencies or types of relationships/scenarios such as 'nested correspondent' scenarios which (could) entail elevated risks of non-compliance.

Authorities and stakeholders agree that the discussion must evolve beyond a qualitative consideration of issues, to one supported by objective, trusted and robust data; while there are challenges in achieving this objective, it is encouraging to see that advocacy efforts and dialogue to date have succeeded in demonstrating clearly, the substantive and important nature of these deliberations.

Observations arising from ICC Banking Commission interventions broadly align with the content of the CPMI Consultative Report. Continuing dialogue and policy refinement will be important to ensure that behaviours motivated by regulatory initiatives align with the intended outcomes from those regulations. At the same time, the growth and evolution of the global ecosystem of correspondent relationships must be allowed to continue.

The ICC Banking Commission supports and endorses the recommendations articulated in the Consultative Report on Correspondent Banking, in summary:

- The use of KYC utilities and the need to develop a 'best practice' or baseline set of required data
- The use of the Legal Entity Identifier, and the mapping of LEIs to SWIFT BIC data for ease and certainty of identification
- The call for clarity on due diligence requirements including KYCC, and the recommendation related to enhanced information-sharing among authorities and stakeholders
- The need to assess and optimize SWIFT message type usage in the context of payments transactions

Additionally, the Banking Commission commends a clear effort by the authors of the Consultation Paper, to present a balanced view of the dynamics at work, be they public sector, policy and regulation oriented, or private sector, commercial and market-related. The development of a framework for an effective, inclusive and sustainable global correspondent network requires that all influencing factors be fairly considered and that stakeholders collaborate to arrive at an informed, equitable understanding of the net effect of de-risking on a global basis. It is worth noting explicitly in this regard, that the impact of de-risking extends far beyond purely the payments area, to cover trade financing, access to foreign currency through correspondent accounts, risk mitigation in international commerce, and numerous other areas.

All in all, it seems that many of the correspondent service-providing banks interviewed in the CPMI jurisdictions are adapting their business model by taking into account the increasing costs, the regulatory requirements and risk management considerations, although some have exited the market voluntarily because of the lack of a business case. Despite these changes on the supply side, most banks are able to obtain cross-border payment services. Nevertheless, banks in some jurisdictions have lost their ability to make cross-border payments. As mentioned above, however, this evolution in correspondent banking seems to have most severely affected smaller banks and/or banks that are located in jurisdictions considered to be very risky.

Source: CPMI Consultative Report on Correspondent Banking, October 2015, p.14

The ICC Banking Commission, our National Committees and Member Banks ultimately wish to ensure that global market coverage by networks of experienced financial institutions continues to be possible in a post-crisis environment, and that the needs of importers, exporters, investors and others engaged in cross-border business, will continue to be effectively met by a secure and well-regulated financial sector. The widely shared objective of financial inclusion is also at the core of Banking Commission concerns in this matter.

The Banking Commission welcomes the express recognition by the BIS, that a sustainable and viable solution to the broad issue of the health of global correspondent relationships demands a more nuanced approach than simply requiring the financial sector to develop solutions to the issues under consideration (CPMI Consultative Report p.11). The engagement of international authorities and national regulators, together with expert groups and relevant stakeholders is welcome and appropriate in devising solutions that assure the achievement of policy objectives while allowing the pursuit of legitimate business and the maintenance of viable global correspondent networks (and related services).

A survey commissioned by the Financial Stability Board and executed by the World Bank earlier this year, brings into focus several notable observations, including recognition that continuing de-risking activity could result in a globally significant and systemic loss of capacity, with particularly adverse effects on developing economies, SMMs and on attempts to improve financial and economic inclusion around the world.

A World Bank survey of jurisdictions and banks commissioned by the FSB has confirmed that roughly half of the emerging market and developing economy jurisdictions surveyed have experienced a decline in correspondent banking services. The withdrawal is not on a global scale, but in some countries may lead to banks relying on a narrow range of providers. If withdrawals continue, this has the potential to rise to a systemic issue for the regions affected as well as to drive some payment flows underground, which would make it harder for authorities to prevent financial crime and the financing of terrorist activity.

Source: Financial Stability Board Report to the G20 (Summary), November 2015

In addition to advancing the discourse and analysis on this issue, the FSB-commissioned report specifically, and very rightly, calls for clarification by the Financial Action Task Force (FATF) relative to AML/CFT regulatory requirements. Industry stakeholders have raised this concern in various interactions with regulatory authorities, and strongly support this directive of the FSB as an important complement to other activities aimed at assuring an effective and sustainable network of global correspondent relationships.

It will be important, in addition to the clarification of requirements, to aim for consistency of interpretation and application of regulatory standards across jurisdictions, (to the extent achievable) given the cross-border and cross-jurisdictional nature of the issues under consideration.

The ICC Banking Commission further endorses the specific mention of the need for local capacity building in developing and emerging markets, with the support of international financial institutions (also referred to as multilateral development banks). Such programs have long been in existence in trade finance, and have proven to be critically valuable in enabling banks from developing markets to effectively support businesses pursuing opportunity in international markets, and have thus contributed directly to international development and to the creation of significant trade-based economic value creation.

The overall conclusions of the World Bank survey as summarized by the FSB, are consistent with observations noted by the ICC Banking Commission in our dialogue with a selected group of partners and member banks.

Three quarters of the large banks responded that the number of correspondent accounts they hold for other banks had declined between end-2012 and mid-2015. The reductions in numbers varied considerably, from less than 5% to more than half in the case of one bank. This retrenchment does not appear to be offset by expansions in services from global competitors and only one of the large banks surveyed reported an increase, of limited magnitude. Similarly, on the respondent bank side, a majority of local and regional banks reported a decline in the scale and breadth of their foreign correspondent banking relationships. Most affected banks reported however that they were able, where needed, to find replacement providers of services, with second and third tier banks.

Source: Financial Stability Board Report to the G20 (Summary), November 2015

The FSB Report to the G20 Summit provides a valuable summary of activities completed and underway by various stakeholders, and illustrates clearly the advancing of deliberations and discourse around the issue of correspondent banking. The Report notes that measures should be taken to eliminate wholesale, sector-wide de-risking activities, for example, as relates to money transfer operators and charitable organizations. This is important in light of the adverse impact on international development and on global remittance flows, which far exceed the amount of official development assistance available to economies in need.

As with the CPMI Consultative Report, the FSB document recognizes the potentially adverse and material impact of regulatory inconsistency across jurisdictions, and proposes a collaborative approach between industry and regulatory authorities to arrive at workable solutions even in the context of differing regulatory standards and interpretation.

Therefore, while the reduction in correspondent banking is also the result of commercial business decisions and strategies, and while some account closures may be necessary when risks cannot be managed as described in Section II, improving the regulatory environment (both internationally and locally) and supporting more efficient due diligence, for instance through enhanced information sharing, can make a difference to help reverse the trend.

Source: Financial Stability Board Report to the G20 (Summary), November 2015

The ICC Banking Commission welcomes the alignment between the CPMI/BIS and the FSB, not only in analysis but in several of the major recommendations and proposed actions flowing from the efforts of both organizations. The Banking Commission fully concurs with the observation that specific efforts must be undertaken to ensure high levels of trust across the system, from regulatory frameworks and enforcement to the identities (for example) or parties sending and receiving remittances, to the robustness of processes and practices within the financial sector.

Discussions undertaken by the ICC Banking Commission intervention reveal that:

- The cost of maintaining basic correspondent relationships, impacted by increasingly stringent due diligence requirements has risen dramatically over the last 3-5 years, from perhaps €15,000 annually to more than €75,000 annually. With global institutions historically maintaining several thousand such relationships, the financial impact is easily appreciated
- A global bank reported a reduction of trade finance business conducted in high-risk markets in the range of 11% over a two-year period, linked directly to de-risking
- A global bank estimates exit from 19 markets and closure of 400 correspondent relationships, with a reduction of about 5% of trade finance capacity as a result of de-risking
- A financial institution noted de-risking related exit from 12 international correspondent relationships and a ceasing of export letter of credit advising to 27 financial institutions
- One respondent noted the exit of 16 financial institution relationships and the ceasing of letter of credit advising activity for 27 financial institutions
- One respondent indicated a reduction of financial institution limits in excess of US \$80 billion, a 16.8% reduction in capacity since June of 2014 alone
- A contributor has estimated that 10 Full Time Equivalent (FTE) Staff have been engaged over a 4 year period on activities related to de-risking analysis, this excludes time spent by senior management on the issue
- One institution noted that regulatory requirements have necessitated the engagement of about 120 FTEs new staff in the compliance area over the period 2011 to 2014 alone
- One contributor noted that about 26% of middle office staff, roughly 1,000 FTE, are tasked with verification and escalation activity related to financial crimes compliance, with nearly 700 of that group focused on sanctions screening
- A respondent reports a complete exit from 11 markets, and exiting 360 correspondent relationships as well as 5,575 commercial relationships (the latter, over a twelve month period) as a direct result of de-risking
- The cost and complexity of due diligence requirements on counterparties remains a concern
- The gap between regulatory policy and on-the-ground enforcement can be significant, with examiners applying materially more stringent standards than those officially articulated by authorities. The situation has been described as a “clear and material disconnect”
- There is no differentiation currently in the level of KYC due diligence required in support of a full account relationship versus a SWIFT-only linkage. The latter is helpful to

enabling trade on the basis of documentary letters of credit, for example. KYC requirements should reflect the nature and scope of the relationship contemplated.

- The shift in expectation relative to the duty of banks in enforcement activity, from “identify and report” to “prevent, identify and report” raises the bar significantly both in terms of the level of due diligence required and in terms of the risk of non-compliance

Multilateral development banks have expressed concern about the impact de-risking is having in emerging markets, particularly the smaller and more vulnerable ones. The Asian Development Bank (ADB) conducts an annual survey study to identify trade finance gaps and their impact on growth and job creation. In its latest survey (Trade Finance Gaps, Growth and Jobs, October 2015) respondents identified de-risking as an important contributor to trade finance gaps. Anecdotal evidence of the adverse impact of de-risking in emerging markets is abundant. There is even concern that relationships that have already been severed may not be repaired in the foreseeable future, even in the event of action from the BIS and regulators. In establishing relationships in poor -addition to 'stopping the bleeding', a discussion about re countries most adversely affected should take place.

There has been notable progress in advancing dialogue and understanding around the issue of correspondent banking however, it is clear that further analysis is required, and that ongoing monitoring will be necessary, even when a way forward is agreed by all parties. Industry contacts describe a situation where the issue around regulatory requirements is not so much about ‘gray areas’ and lack of clarity, but about moving targets and shifting expectations that are far more challenging to address.

The compliance environment in which we operate continues to be dynamic. This means that we have to constantly keep our procedures under review to ensure these are in line with our current understanding of regulators requirements around the world. This has not only caused us to devote significantly more resource to compliance over time but has also, due to the regulatory uncertainties, our appetite to do certain business and the parties that we will now deal with. Historically it was relatively easier than today to manage sanctions related risk because of the more comprehensive and or list based nature of the sanctions programmes that were put in place. The requirements of the targeted sanctions by the EU and US against Russia and Crimea related to the UK are complex and it is difficult to build policies to effectively manage the risks involved, particularly without these holding up the underlying transactions whilst the necessary enquiries are made. Regulators have indicated that they believe the new approach to sanctions is a more effective approach and therefore this is likely to form the basis of new sanctions regimes going forward.

Source: Global Trade Bank, Expert Commentary

The ICC Banking Commission, as the global authority on industry standards and practices in various areas of international banking, would welcome the opportunity to contribute to the ongoing efforts of the FSB, the BIS, the FATF and others, to effectively address the range of issues related to regulation and correspondent banking.

There has been some expression of interest in the notion of a compliance certification process and standard, with reviews or audits completed by approved and trusted third parties, and a clear articulation of a “Gold Standard” of compliance. The ICC Banking Commission is perhaps uniquely placed to help develop and disseminate such a standard. A compliance audit and certification process can be an excellent and very concrete complement to the various recommendations of the CPMI and the World Bank/FSB survey, aligning well with the various proposals encouraging collaboration between regulatory authorities and industry leadership.

Thank you for the opportunity to respond to the Consultative Paper, we look forward to further advancement of the dialogue and deliberations on this global and systemically important issue, and are fully prepared to contribute substantively to the implementation of agreed solutions and recommendations.

Sincerely,

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