

Developing and Managing a Correspondent Banking Framework

Presented by:
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Today's Speaker



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- Assist clients with complex Bank Secrecy Act and Anti-Money Laundering and Sanctions compliance and investigative matters
- Directs BSA/AML consulting engagements including transaction look-backs, risk assessments, independent testing of compliance, and model validations and calibrations
- Brings over 40 years of experience in banking, regulatory compliance, and financial crimes investigations
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Agenda

Today's presentation provides an overview of the regulatory framework needed to adhere to international financial regulations, to facilitate international trade and provide a seamless and efficient domestic banking experience for the citizens of Suriname.

Introduction

- Economic development and prosperity in Caribbean countries require a stable and secure financial sector.
- The ability to access international finance and credit, trade with other countries, and secure foreign investment form the foundation of this stability.
- Vital to performing these actions are correspondent banking relationships, which financial institutions, governments, and citizens use to conduct cross-border financial transactions.
- Correspondent banking relationships are crucial to the proper functioning of economies and financial systems, especially for small countries in the Caribbean.
- Direct access to U.S. and European markets facilitates banks' operational independence, allows them to provide critical services to customers, and, in some cases, is necessary for the banks' continued existence.

- First, the most traditional form of correspondent banking involves a respondent bank entering into an agreement with a correspondent bank to execute payments on its own behalf and on behalf of its direct customers.
- Second, “nested” correspondent banking refers to the use of a correspondent banking relationship by a respondent bank’s intermediate customers (e.g., banks and financial institutions), which could then use the relationships for their own clients.
- Third, payable-through accounts which are similar to nested correspondent banking, but in the case of these accounts, the respondent bank allows its intermediate customers to access the correspondent account directly to conduct business on their own behalf.

Typical Forms of Correspondent Banking

Typical Services Offered through Correspondent Banking

- Correspondent accounts may include, but are not limited to, the following:
 - Cash management services, including bulk shipments of currency
 - International funds transfers
 - Check clearing, including U.S. dollar drafts
 - Payable-through accounts
 - Pouch activities
 - Foreign exchange services
 - Overnight investment accounts (sweep accounts)
 - Loans and lines of credit
 - Trade finance activities, including letters of credit

- The current correspondent banking environment in the Caribbean can be summed up in one word, “de-risking.”
- There are two main drivers of financial de-risking in the Caribbean:
 - 1) Limited profitability for correspondent banks due to the relatively small size and volume of transactions; and
 - 2) Countries’ classification as “high-risk jurisdictions,” and their perceived weak regulatory frameworks to address money laundering and terrorism financing.
- Both drivers have contributed to a broad decline in correspondent banking relationships.

Current Caribbean Correspondent Banking Environment

Current Caribbean Correspondent Banking Environment (cont'd.)

Change in correspondent banking relationships, transaction volumes, and transaction values across the Caribbean countries, 2011-2022¹

14 Americas Jurisdictions (of 220 total globally)	CBR Counterparties		Transaction Volume		Transaction Value	
	Change (%)	Global Rank (/220)	Change (%)	Global Rank (/220)	Change (%)	Global Rank (/220)
Belize	-50.8	30	-56.2	18	-43.2	22
St. Vincent & the Grenadines	-44.8	47	-5.2	15	-46.9	81
Dominica	-41.6	56	-55.3	49	-8.5	23
The Bahamas	-41.3	62	-27.8	103	25.4	54
Jamaica	-40.0	65	20.7	200	91.9	111
Trinidad & Tobago	-39.1	69	22.9	151	46.0	118
Suriname	-36.4	82	-10.1	65	3.0	73
St. Kitts & Nevis	-36.0	85	66.3	69	5.5	160
Grenada	-33.3	100	125.3	121	30.5	189
Barbados	-33.0	102	-28.3	79	13.4	53
St. Lucia	-31.5	111	-1.7	70	7.4	83
Antigua	-30.2	118	5.7	85	16.7	94
Haiti	-27.5	129	38.1	166	51.8	139
Guyana	-20.5	171	28.7	184	66.9	129

Current Caribbean Correspondent Banking Environment (cont'd.)

- Profitability limits identified by correspondent banks are based on a risk versus reward calculus.
- Correspondent banking is a fee-based service, and given the small populations of Caribbean countries, there are inherently small volumes of transactions occurring between correspondent and respondent banks.
- Correspondent banks weigh those potential profits against stringent U.S. regulations that threaten heavy fines and sanctions if a Caribbean financial institution that has a relationship with a U.S. correspondent bank is unable to mitigate risks, such as financial crimes.
- In many cases, the risk of the relationship with the Caribbean counterparty outweighs the potential reward.
- Factoring into the perceived risks of engaging with Caribbean jurisdictions are concerns from U.S. banks about the region's ability to manage and mitigate illicit finance.
- Correspondent banks perceive that despite increased capacity to adhere to Anti-Money Laundering (AML)/Countering the Financing of Terrorism (CFT) standards, Caribbean governments have weak regulatory frameworks that do not sufficiently address concerns over financial crimes.

- Further, many Caribbean countries that face financial de-risking are continually classified by the U.S. Department of State's annual International Narcotics Control Strategy Report as jurisdictions with high rates of money laundering and drug trafficking.
- Correspondent bank failures to comply with its specific and general obligations regarding correspondent accounts has resulted in significant criminal and civil liability, including deferred prosecution and other settlement agreements, with fines and forfeitures in many billions of dollars.

Current Caribbean Correspondent Banking Environment (cont'd.)

How is Suriname Perceived in the U.S. by Correspondent Banks & Bank Regulators¹

- Suriname is a transit country for South American cocaine destined mostly for Europe.
- Most illicit drugs are smuggled in cargo containers through Suriname, but commercial and private air transport and human couriers also conceal smuggled cocaine.
- Suriname's weak border controls and infrastructure make illicit drug detection and interdiction efforts difficult in the country's sparsely populated coastal region and isolated jungle interior.
- Corruption continues to be a challenge for Suriname; however, the Santokhi Administration has signaled recent commitment to improve transparency and combat drug-related corruption.

How is Suriname Perceived by the Caribbean Financial Action Task Force (CFATF)

- Jurisdiction with strategic AML/CFT deficiencies that has made significant progress in addressing such deficiencies.
- The CFATF acknowledges the significant progress made by Suriname in improving its AML/CFT regime and notes that Suriname has established the legal and regulatory framework to meet its commitments in its agreed Action Plan regarding the strategic deficiencies that the CFATF had identified. Suriname and the CFATF should continue to work together to ensure that Suriname's reform process is completed, by addressing its remaining deficiencies and continue implementing its Action Plan.

Managing Correspondent Banking Risks from the Perspective of the Correspondent Bank

- Correspondent banks typically manage their relationships with respondent banks with two principal objectives in mind:
 - 1) Meeting specific regulatory obligations in connection with maintaining correspondent relationships; and
 - 2) Meeting general compliance and supervisory obligations to report suspicious activity, prevent money laundering, and comply with economic sanctions.

Managing Correspondent Banking Risks from the Perspective of the Correspondent Bank (cont'd.)

- Specific regulatory obligations in connection with maintaining correspondent relationships:¹⁴
 - In the U.S., Congress specifically addressed the AML risks of correspondent banking relationships in sections 311 to 313 of the USA PATRIOT Act, which require U.S. correspondent banks to conduct specific enhanced due diligence on relationships with respondent banks or terminate those relationships
 - U.S. regulators have issued guidance emphasizing that due diligence should be focused on the respondent banks and not on any respondent bank customers.
 - In most instances there is no obligation to conduct Know Your Customer's Customer (KYCC) on respondent bank customers; however, customer due diligence (CDD) requires that correspondent banks identify and understand their respondents' banking activities and know if the respondents maintain additional correspondent banking relationships to identify "nested" bank accounts held by the respondent bank.
 - The regulatory expectation that correspondent banks conduct due diligence on respondent banks will permeate the correspondent bank's relationship with both the respondent bank and the regulator and will continue to be a significant issue in the supervision process.

- General compliance obligations:

- From an AML/CFT perspective, banks are required to report suspicious activity and reasonably manage their risk of being exploited for money laundering purposes.
- From a sanctions perspective, U.S. authorities expect correspondent banks to manage their risks wherever they lie.
- Fulfilling those responsibilities and managing those risks is challenging without access to information about the respondent bank's underlying customers, which is not often immediately available.
- In lieu of robust due diligence on a respondent bank's customer(s), correspondent banks typically use requests for information (RFIs) to obtain detailed information about the state of a respondent bank's Anti-Financial Crimes (AFC) program, home country AFC regime, effectiveness of its AFC supervisor, and, on a case-by-case basis, specific information about transactions or respondent bank customers that raise red flags in the correspondent bank's transaction monitoring system.

Managing Correspondent Banking Risks from the Perspective of the Correspondent Bank (cont'd.)

What's Required of Banks in the U.S. Offering Correspondent Banking Services?

– Sections 311 – 313 of the USA PATRIOT Act

- Section 311 of the USA PATRIOT Act grants the U.S. Secretary of the Treasury the authority, upon finding that reasonable grounds exist for concluding that a foreign jurisdiction, institution, class of transaction, or type of account is of “primary money laundering concern,” to require domestic financial institutions and financial agencies to take certain “special measures” against the entity of primary money laundering concern.
- These special measures range from requiring additional due diligence and special attention – concerning particular account transactions among U.S. financial institutions – to prohibiting the opening or maintenance of any correspondent or payable-through accounts. The following special measures can be imposed individually, jointly, in any combination and in any sequence:
 - Recordkeeping and reporting certain transactions;
 - Collection of information relating to beneficial ownership;
 - Collection of information relating to certain payable-through accounts;
 - Collection of information relating to certain correspondent accounts; and
 - Prohibition or conditions on the opening or maintaining of correspondent or payable-through accounts.

- The goal of Section 312 of the USA PATRIOT Act is to help prevent money laundering through accounts that give foreign financial institutions a base for moving funds through the U.S. financial system by requiring financial institutions to establish due diligence programs consisting of policies, procedures, and controls for correspondent accounts for foreign financial institutions.
- If a correspondent account is established, maintained, administered, or managed in the United States for a foreign bank the U.S. bank's due diligence program must include Enhanced Due Diligence (EDD). EDD procedures designed to ensure that the U.S. bank, at a minimum, takes reasonable steps to:
 - Conduct enhanced scrutiny of such correspondent account to guard against money laundering to identify and report any suspicious transactions in accordance with applicable law and regulation. This enhanced scrutiny must reflect the risk assessment of the account and include, as appropriate:
 - Obtaining and considering information relating to the foreign bank's AML program to assess the risk of money laundering presented by the foreign bank's correspondent account.
 - Monitoring transactions to, from, or through the correspondent account in a manner reasonably designed to detect money laundering and suspicious activity.

What's Required of Banks in the U.S. Offering Correspondent Banking Services?

– Sections 311 – 313 of the USA PATRIOT Act (cont'd.)

What's Required of Banks in the U.S. Offering Correspondent Banking Services?

– Sections 311 – 313 of the USA PATRIOT Act (cont'd.)

- Obtaining information from the foreign bank about the identity of any person with authority to direct transactions through any correspondent account that is a payable-through account and the sources and the beneficial owner of funds or other assets in the payable-through account.
- Determine whether the foreign bank for which the correspondent account is established or maintained in turn maintains correspondent accounts for other foreign banks that use the foreign bank's correspondent account established or maintained at the U.S. bank. If so, the U.S. bank must take reasonable steps to obtain information relevant to assess and mitigate money laundering risks associated with the foreign bank's correspondent accounts for other foreign banks, including, as appropriate, the identity of those foreign banks.
- Determine, for any correspondent account established or maintained for a foreign bank whose shares are not publicly traded, the identity of each owner of the foreign bank, and the nature and extent of each owner's ownership interest.
- Section 313 of the USA PATRIOT Act prohibits banks from establishing, maintaining, administering, or managing a correspondent account in the United States for, or on behalf of, a "foreign shell bank", unless the foreign shell bank is a regulated affiliate. A "foreign shell bank" is defined as a foreign bank without a physical presence in any country.

- The requirements of both Financial Action Task Force (FATF) Recommendations 10 and 13 must be met in all cases before cross-border correspondent banking services may be provided to a respondent institution.
- FATF Recommendation 13 requires additional measures to be applied to cross-border correspondent banking relationships, in addition to performing the customer due diligence (CDD) and enhanced due diligence (EDD) measures in FATF Recommendation 10 for high-risk customers.
- As a first step, the correspondent institution should identify and verify the identity of the respondent institution, using reliable, independent source documents, data or information.
- It should also identify and take reasonable measures to verify the identity of the beneficial owner(s), such that the correspondent institution is satisfied that it knows who the beneficial owner(s) of the respondent institution is/are. The information about the ownership and control structure includes conducting verification enabling the correspondent institution to be satisfied that the respondent institution is not a “shell bank.” FATF defines a “shell bank” as a bank that has no physical presence in the country in which it is incorporated and licensed, and which is unaffiliated with a regulated financial group that is subject to effective consolidated supervision.

What's Required of Banks in the E.U. Offering Correspondent Banking Services?

– FATF Recommendations 10 and 13

What's Required of Banks in the E.U. Offering Correspondent Banking Services?

– FATF

Recommendations 10 and 13 (cont'd.)

- Additionally, the correspondent institution should gather sufficient information to understand the purpose and intended nature of the correspondent banking relationship with the respondent institution. This includes understanding what types of customers the respondent institution intends to service through the correspondent banking relationship and how it will offer services (e.g. through nested relationships), including the expected activity level, the transaction volume and value, the nature of the planned transactions and the extent to which any of these are assessed as high risk by the respondent institution.
- The correspondent institution should also gather sufficient information and determine from publicly available information the reputation of the respondent institution and the quality of its supervision, including whether (and when) it has been subject to a money laundering/terror financing investigation or regulatory action.
- In addition, the correspondent institution should assess the respondent institution's AML/CFT controls. In practice, such an assessment should involve reviewing the respondent institution's AML/CFT systems and controls framework. The assessment should include confirming that the respondent institution's AML/CFT controls are subject to independent audit (which could be external or internal). A more detailed/in-depth review should be conducted for higher risk relationships, possibly including reviewing the independent audit, interview of compliance officers, a third-party review and potentially an onsite visit.

- The correspondent institution should also understand how the respondent institution will be offering services available through the correspondent banking relationship to its customers and assess the nature and level of risk associated with offering arrangements. There are several possible arrangements for offering services:
 - By establishing *correspondent accounts* to which the respondent institution's financial institution customers do not have direct access, but instead transact indirectly through the account via payment instructions delivered to the respondent institution;
 - By establishing *nested relationships* (i.e. downstream banking) which require that:
 - the correspondent institution is duly informed about the existence of such relationships and the operations/transactions of the customers of the nested institutions, that the locations in which the nested institutions conduct business are transparent to, and understood by, the correspondent institution, and the respondent is transparent in formatting payment instruction, so all involved parties are included for monitoring and screening purposes;
 - the correspondent institution has measures in place to detect potential, undisclosed nested relationships provided by the respondent and takes appropriate follow-up action when a respondent does not disclose the existence of a nested relationship;

What's Required of Banks in the E.U. Offering Correspondent Banking Services?

– FATF Recommendations 10 and 13 (cont'd.)

What's Required of Banks in the E.U. Offering Correspondent Banking Services?

– FATF

Recommendations 10 and 13 (cont'd.)

- the correspondent institution understands the respondent's control framework with respect to those relationships. Such review should consider the implementation of appropriate controls to address the underlying risks posed by these relationships (for instance, if the transaction monitoring procedures are comprehensive of the relevant factors, whether they are based on manual transaction reviews and the accuracy of the automated ones, whether the institution has the resources to conduct such reviews, etc.)
- By establishing *payable-through accounts* which can also be offered provided that the correspondent institution identifies risks associated with the relationship and applies enhanced controls to monitor transaction activity that are commensurate with the identified risks. The correspondent should have policies, procedures and processes in place to enable it to identify the ultimate user of the account and needs to be satisfied that the respondent institution has conducted sufficient CDD on the customers having direct access to the account of the correspondent institution, has appropriate controls in place to identify and monitor the transactions conducted by those customers and is able to provide relevant, individual CDD information upon request to the correspondent institution.

- Effective Risk Management:

- Correspondent banks want to establish relationships with respondent banks that do not create additional enforcement risks and that minimize compliance burdens by addressing Anti-Financial Crimes (AFC) risks before they are potentially passed on to a correspondent bank.
- The key to ensuring that senior management of a correspondent bank can get comfortable with a respondent bank's AFC program and approve a correspondent account is for the correspondent bank to understand fully the nature of the respondent bank's business and the extent and effectiveness of its AFC systems and controls.
- The building blocks of a best-in-class AFC program that a correspondent bank will look for in its respondent bank relationships include:
 - appropriate risk assessment based on the respondent bank's business and operating strategy;
 - robust AFC compliance policies and procedures (including Know Your Customer (KYC) processes and the reporting of suspicious activity);
 - a governance structure providing for appropriate escalation to experienced, well-trained, engaged, and accountable executives and to the board of directors, if appropriate;

What Can a Respondent Bank Do?

What Can a Respondent Bank Do? (cont'd.)

- a culture of compliance that ensures sufficient resources to the AFC compliance program;
 - periodic firm-wide training for all personnel with first-, second-, or third-line AFC responsibilities; and
 - Regular, thorough, and independent reviews and internal audits of the AFC program.
- The correspondent bank will also form a view about the reputation of the respondent bank and the quality of its regulatory supervision, possibly with the assistance of a corporate intelligence firm and local legal advice, and often in consultations with the correspondent bank's own regulators.

- After a respondent bank has built out its program, it must effectively, and often proactively, communicate its approach to the correspondent banks in which it is seeking to establish a correspondent account.
- The respondent bank must establish a dialogue with its correspondent bank, through extensive ad hoc consultations, site visits, and regular updates, to demonstrate that it has appropriately identified its AFC risks and is continuously taking appropriate steps to address such risks.
- It also is important for a respondent bank to identify proactively those transactions that may be considered high-risk by its correspondent bank and explain how and why it decided to process the transaction.
- Respondent banks need to be able to prove that they can reliably identify risks and take meaningful steps to mitigate them, even as the risk environment evolves.
- This kind of transparency can be challenging as many respondent banks may not lawfully share certain types of customer due diligence data with third parties, such as correspondent banks, due to strict data protection and bank secrecy laws.
- The ability to share customer data is critical to establishing productive relationships with correspondent banks.

Engagement with the Correspondent Bank

Responsibilities of Central Banks and Government Regulators

- Central Banks and government regulators play a critical role in the oversight and the management of the risks posed by correspondent banking.
- Regulatory bodies must develop and implement robust risk-focused compliance testing regimes.
- Central Banks and government regulators play a critical role in the issuance of guidance and the setting of regulatory expectations.
- A lack of proper oversight by either a Central Bank or government regulators leads to a diminishment of reputations among peers.
- Correspondent banks consider respondent bank's home country AML/CFT & Sanctions regimes as well as the perceived effectiveness of the respondent bank's home country regulator as part of their due diligence.

- Legislators and members of Parliament (MPs) play a critical role in budgeting and budget oversight, passing legislation that have significant economic impact and holding governments to account on behalf of citizens.
- They are also critical partners in building political support for implementing AML/CTF policy.
- Meetings with legislators and MPs help U.S. Congressional staff better understand the concerns of other countries and to discuss best practices in policymaking.
- Most importantly legislators and MPs set the “tone at the top” for all involved parties.

Responsibilities of Legislators and Parliamentarians

Responsibilities of Financial Intelligence Units

- Financial intelligence units (FIUs) constitute a critical component in the development of effective strategies for anti-money laundering and combatting the financing of terrorism.
- An FIU is a central national agency responsible for receiving, analyzing, and transmitting disclosures on suspicious transactions to the competent authorities.
- The Financial Action Task Force (FATF) recommendations set a standard that countries should establish an FIU with the three core functions and contains other provisions that relate to the exercise of these functions.
- Combating the crimes of money laundering and financing terrorism is essential to the integrity of financial systems but, if these efforts are to be successful, traditional law-enforcement methods need to be supported by the contribution of the financial system itself, in particular the reporting suspicious transactions to an FIU.
- Financial institutions hold critical information on transactions that may hide criminal schemes.
- Although this information is covered by necessary confidentiality regimes, it must be made accessible to law-enforcement agencies to enable them to trace criminal money channels.
- FIUs play an important role in the public dissemination of trends and methods related to money laundering and the financing of terrorism.
- Seek membership with the Egmont Group of FIUs.

- For a respondent bank, consistent correspondent account access can mean independence, stability, and strategic success.
- While correspondent banks may bring another layer of increased scrutiny to these relationships, there are steps that respondent banks can take to protect themselves.
- At a minimum, establishing and maintaining a solid AML/CFT and Sanctions compliance programs is a foundational element for a respondent bank seeking to establish a long-lasting partnership in a correspondent banking relationship.
- Central Banks and government regulators play a critical key role in ensuring that the risks posed by correspondent banking is identified and mitigated by both the correspondent and respondent banks.

In Closing

Questions?




Contact Us!

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