World Council

February 22, 2017

Filed electronically
William Coen
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002
Basel, Switzerland

Re: Consultative Document: *Revisions to the annex on correspondent banking* (Nov. 2016)

Dear Mr. Coen:

World Council of Credit Unions (World Council) appreciates the opportunity to comment on the Basel Committee on Banking Supervision's consultative document *Revisions to the annex on correspondent banking.*[1] Credit unions are cooperative depository institutions and World Council is the leading trade association and development organization for the international credit union movement. Worldwide, there are over 60,000 credit unions in 109 countries with USD 1.8 trillion in total assets serving 223 million natural person members.[2]

1. "De-Risking"

World Council supports the Basel Committee's efforts to update its correspondent banking guidance to help address "de-risking" and incorporate the Financial Action Task Force's recently updated interpretive note on correspondent banking anti-money laundering/countering the financing of terrorism (AML/CFT) standards.[3]

De-risking affects credit unions and other financial cooperatives in two ways: (1) in financial cooperatives' capacity as service providers, which they provide primarily to other cooperative financial institutions; and (2) when financial cooperatives have difficulty establishing or maintaining bank accounts that they need to facilitate domestic or cross-border payments activities. Credit unions and other financial cooperatives in jurisdictions including Canada, the Caribbean, the United Kingdom and the United States of America have faced challenges establishing and maintaining correspondent bank accounts in recent years.

Banks' de-risking is often the result of a combination of operational and competitive factors that intersect with AML/CFT compliance requirements, including:

a. The level of profitability of bank's correspondent banking relationship with a financial cooperative may be low compared to the perceived compliance and reputational risks;

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[1] Basel Committee on Banking Supervision, *Revisions to the annex on correspondent banking* – Consultative Document (Nov. 2016), *available at* http://www.bis.org/bcbs/publ/d389.htm.
[2] World Council of Credit Unions, *2015 Statistical Report* (2016), *available at* http://www.woccu.org/publications/statreport.
[3] Financial Action Task Force, *Correspondent Banking Services* (Oct. 2016), *available at* http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-Correspondent-Banking-Services.pdf.

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b. The financial cooperative is the bank's competitor for loans, deposits, and payments services;

c. Most banks require senior management approval of correspondent banking relationships even if the correspondent account is purely domestic; and

d. Confusion regarding to what extent correspondent institutions are responsible for due diligence on their customers' customers.

World Council supports the Basel Committee's efforts to clarify correspondent banking AML/CFT rules. We believe that clearer correspondent banking rules will reduce de-risking and help make it easier for credit unions and other financial cooperatives to establish and maintain correspondent bank accounts.

2. Ongoing Monitoring and the FATF "Request for Information" Protocol

World Council strongly supports the statement in Paragraph 25 that a correspondent bank's "level of ongoing monitoring should be commensurate with the respondent bank's' risk profiles." This statement incorporates the Principal of Proportionality into the standard and should help limit its regulatory burdens on smaller respondent institutions. We urge the Committee to finalize this statement as proposed.

World Council also supports the Basel Committee's reference in Paragraph 28 to the Financial Action Task Force's (FATF) "Request for Information" information-sharing procedure.[4]

We urge the Committee, however, to add additional commentary on the FATF's Request for Information approach in the final version of this standard.

The FATF developed its Request for Information procedures based on industry practices such as the Wolfsberg Group questionnaire.[5] The Request for Information approach provides a flexible method of sharing information that is not reliant on payments remittance information (which can involve legacy systems that truncate payments messages because they do not support extended payments remittance information).

We believe that additional commentary drawn from the FATF's Request for Information approach should be included in the Committee's guidance, as well as a citation to the relevant sections of the FATF's correspondent banking guidance,[6] would help users of this standard better understand a Request for Information and its potential to address situations where a correspondent institution needs additional information about a transaction that is not available through other means.

3. Payment Message Truncation and Remittance Information Quality

In response to the "Box 3" question concerning the "Quality of payment messages:" We urge the Committee to clarify that the Request for Information protocol should be used to resolve payments

[4] *See id.* at ¶¶ 3, 32-33.
[5] Anti-Money Laundering Questionnaire – Wolfsberg Anti-Money Laundering; http://www.wolfsberg-principles.com/pdf/home/Wolfsberg-Anti-Money-Laundering-Questionnaire-2014.pdf (last visited February 22, 2017).
[6] Financial Action Task Force, *Correspondent Banking Services* ¶¶ 3, 32-33 (Oct. 2016).

message ambiguities, incomplete fields, and so forth. There may be instances when it is not possible for an institution to receive the high quality of remittance information envisioned by proposed Paragraphs 31 through 35—such as full originator and beneficiary information, Legal Entity Identifiers (LEIs), etc.—because of the technological limitations of legacy payments messaging systems. World Council urges the Committee to emphasize that the Request for Information protocol established by the FATF should be used to resolve ambiguities in situations where high quality payments message information is not available, such as if the payment message has been truncated because it was processed using a system that did not support extended-character remittance information.

International payments processed over Society for Worldwide Interbank Financial Telecommunication (SWIFT), for example, are often originally initiated domestically by a non-SWIFT member respondent institution using another payments system. Not all domestic payments systems around the world support extended-character remittance information. In addition, adapting a SWIFT-member institutions' back office systems to support SWIFT's upgrades to its messaging system, such as the recent SWIFT Global Payments Initiative upgrades,[7] are typically expensive and may not always occur quickly.

Payments processed at some point by a system (or institution) that does not support an upgraded extended messaging format will likely be truncated and thereafter would no longer have the proposed high quality remittance information even if the payment originally included such high-quality information using extended messaging features. We believe that truncated message problems will exist for at least the medium-term, especially with respect to legacy domestic electronic payments systems in middle-income and developing countries.

We urge the Committee to clarify that the FATF's Request for Information approach can be used to facilitate information sharing in instances—such as because of the technological limitations of legacy messaging systems—where payment remittance information does not meet the standards proposed in Paragraphs 31 through 35.

4. **<u>Credit Unions Serving Employees of International Organizations and Government Agencies with PEPs</u>**

World Council urges the Basel Committee to clarify that credit unions serving the employees of international organizations or national government agencies have characteristics that help mitigate the AML/CFT risks normally associated with an institution serving Politically Exposed Persons (PEPs). These institutions typically have a "common bond" restriction on membership which legally requires them to serve only a narrow subset of the public, i.e. the organization's or agency's staff and their families.

Credit unions serve the employees of international organizations including the United Nations' agencies, the International Monetary Fund, the World Bank, and the Organization of American States. Credit unions also serve the employees of government agencies in many jurisdictions including the United Kingdom and the United States of America. These institutions can legally only do business with their own members, and are typically subject to "common bond" legal requirements that restrict their membership

[7] *See* "SWIFT global payments initiative;" https://www.swift.com/our-solutions/global-financial-messaging/payments-cash-management/swift-gpi (last visited Feb. 20, 2017).

primarily to the current and former employees of these international organizations or government agencies and their families.

Of course, these international organizations and government agencies have high-ranking agency staff members who are Politically Exposed Persons (PEPs), and who are usually credit union members. The institutional profiles of credit unions with the mission to serve employees of these international organizations and government agencies, however, are fundamentally different from commercial banks that happen to have disproportionate connections to PEPs.

It is relatively easy for credit unions that serve international or domestic agencies to recognize suspicious financial transactions initiated by their members, such as those related to corruption, because transactions related to corruption are not consistent with the normal financial behaviour of the organization's or agency's staff. Unlike a commercial bank, most of these credit unions' members are physical persons who have the same employer and transact on their accounts in a more or less predictable manner. For example, large wire transfers with questionable sources of funds stand out at a credit union serving an international organization or government agency, much more so than at a commercial bank serving large corporations.

We urge the Committee to clarify that credit unions serving international organization and government agency employees typically have factors—such as "common bond" restrictions on membership—that lower their potential for being subject to financial abuse, notwithstanding that the organization's or agency's high-ranking staff members may be PEPs.

5. **<u>Nested Relationships Involving Wholesale Financial Cooperatives</u>**

Nested correspondent banking relationships can exist between wholesale financial cooperatives—which are typically called "central credit unions," "corporate credit unions," "cooperative federations" or "credit union service organizations"—and their members, which are credit unions and other financial cooperatives serving consumers at the retail-level. Nested relationships occur when an institution has a correspondent relationship with a number of respondent financial institutions, such as when a wholesale financial cooperative has a number of respondent, retail-level, member financial cooperatives.

Wholesale financial cooperatives typically provide their correspondent banks with a list of their respondent member institutions, and these relationships are also typically disclosed to correspondents through remittance transfer information identifying the originating institution. Many wholesale financial cooperatives also post on their websites the names of the retail-level institutions that are its members and use its services.

Wholesale financial cooperatives monitor the payments activities of their member institutions in order to protect their brand and the cooperative system's mutual liability risk as well as to comply with AML/CFT ongoing monitoring requirements. If a retail-level cooperative that is a member of a wholesale financial cooperative uses its accounts for suspicious activities, the wholesale institution will typically suspend the ability of the retail institution's ability to transact on its accounts, or close the accounts, unless the suspicious activities can be explained adequately through information sharing. Further, many wholesale financial cooperatives do not allow their member institutions to have downstream nested relationships of their own to ensure that the wholesale cooperative institution is always dealing directly with the institution that originated the payment order.

Regarding detecting downstream risks—such as undisclosed nested relationships or undisclosed relationships with money services businesses—wholesale cooperatives typically look for volumes of transactions from their member institutions that would be unusually high for a retail-level cooperative engaged in community banking. A wholesale financial cooperative will investigate an unusually high level of volume through information requests to determine if the retail-level cooperative has an undisclosed relationship. A wholesale financial cooperative will generally suspend or close the transactional accounts of a retail-level financial cooperative that is not able to explain its unusually high volumes of transaction, as well as inform the appropriate regulatory authorities about the suspicious activities and the account closure.

Generally, this includes the wholesale financial cooperative informing the prudential supervisor of the retail-level institution about account closures. This is because a financial cooperative that is not able to access correspondent banking services presents safety and soundness concerns, including acute liquidity and solvency risks as well as reputational risks, because it will not be able to access the interbank lending market, receive loan payments from its members or disburse loan proceeds, and could default on existing financial obligations because it would not be able to pay them on time.

6. Assessment of the Respondent Institution's AML/CFT Controls

World Council strongly supports the statement in paragraph 21 that "[a]ll correspondent banking relationships should be subject to an appropriate level of due diligence following a risk-based approach . . . ." This statement should help limit unreasonable compliance burdens by incorporating the Principal of Proportionality into a correspondent institution's customer due diligence approach and should help smaller, less-complex institutions establish and maintain correspondent bank accounts. We urge the Committee to finalize this statement as proposed.

World Council believes that the other aspects of proposed Paragraphs 21 and 22 regarding correspondent banks' customer due diligence requirements are sufficiently clear.

7. Know Your Customer (KYC) Utilities

World Council believes that correspondent banks using "Know Your Customer (KYC) Utilities" and/or the Global Legal Entity Identifier System to learn more about a particular credit union could help reduce de-risking, but only if the KYC Utility or Global Legal Entity Identifier System includes information on the credit union in question.

We are concerned that smaller credit unions may not be included in a KYC Utility's database and that obtaining a Legal Entity Identifier has costs in many jurisdictions.

We urge the Committee to clarify the final version of this guidance to emphasise that correspondent institutions should utilize other methods of information gathering, such as "by liaising directly" as proposed in Paragraph 21. In the case of ongoing monitoring, we believe that the FATF's Request for Information protocol discussed in Paragraph 28 should be used in situations where a KYC Utility or the Global Legal Entity Identifier System is being used for monitoring purposes and a search does not provide sufficient information about a respondent institution or the transaction in question.

8. Guide to Account Opening: Annex 4

World Council generally supports the proposed additions in Paragraphs 6bis and 6ter to the Committee's Guide to Account Opening and Customer Due Diligence (CDD). We believe, however, that the first sentence of Paragraph 6ter should be clarified by adding the following underlined text:

> "In any case, the ultimate responsibility for CDD remains with the bank <u>establishing the customer relationship</u>."

We believe that stating expressly that "the bank" referenced by the first sentence of Paragraph 6ter is the bank opening the account will help users of this standard better understand which entity is responsible for the customer due diligence, especially if this guidance is translated into other languages. We believe that this clarification is important because confusion over which banking institution is responsible for customer due diligence has been one of the drivers of "de-risking."

World Council appreciates the opportunity to comment on the Basel Committee's consultative document on the *Revisions to the annex on correspondent banking*. If you have questions about our comments, please feel free to contact me at medwards@woccu.org or +1-202-508-6755.

Sincerely,

Michael S. Edwards
VP and General Counsel
World Council of Credit Unions