

A toolkit for correspondent banking supervision

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Abstract

Over recent years, de-risking practices threaten to cut off access to the global financial system for local banks in various regions of the world, therefore, it is essential to assess ML/FT risks associated with correspondent banking relationships to mitigate their effects. This paper contributes by proposing a Supervisory Toolkit on Correspondent Banking, in order to provide tools that facilitate supervision; it is being currently applied to the risks assessments carried out in Peru. The Supervisory Toolkit is comprised of two parts: (i) Guide for the Supervision of the Prevention and Management of ML/FT Risks System in Correspondent Banking and (ii) ML/FT Risk Assessment Methodology for Correspondent Banking Relationships. By applying the Toolkit in Peru, supervisors were able to evaluate the level of risk of local banks, applying a risk-based approach according risks derived from their correspondent banking relationships. Also, supervisors were able to have a better comprehension of the relevant characteristics of the correspondent banking relationships, the level of risks of the foreign banks with which said relationships are maintained, the level of risk exposure and the quality of risk management of the local banks.

Keywords: De-risking, Correspondent Banking, Supervisory Toolkit, ML/FT Risks

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I. INTRODUCTION

Correspondent banking relationships (CBRs) play a vital role in economic development, trade and financial inclusion. Nonetheless, over the recent years, banks have chosen to withdraw from their correspondent banking relationships, due to, among many other factors, the new macroeconomic environment and regulatory changes. This phenomenon is called de-risking.

Some drivers of these phenomenon are the following: low return business lines for correspondent banking, increased ML/FT risk management requirements, information asymmetries and increased competition through new models supported by technology (ASBA, 2017). Additionally, the quality of the supervisor's supervision represents a factor to be taken into account by the banks that choose to withdraw from their CBRs.

Consequently, the economies where the banks that suffer de-risking operate are limited in their options to transfer and receive money, which impacts financial inclusion and sustained growth. In the same way, these increase a migration of high-risk clients to low-capacity entities, the use of less regulated channels, and concentration of risk in few entities.

This paper presents a review of the literature on the concepts of correspondent banking and the phenomenon of de-risking, and proposes a supervisory toolkit with the purpose of supporting the process of the supervision of correspondent banking relationships and mitigate the risk of de-risking.

The document is divided into seven sections. Section two presents the theoretical framework, defining correspondent banking and the phenomenon of de-risking based on the literature reviewed. Section three explains the fundamentals behind the Supervisory Toolkit proposal. Section four details the data to be collected for application of the Methodology. Section five provides a description of the variables to use in the ML/FT Risk Assessment Methodology for Correspondent Banking Relationships. Finally, the results of the application of the methodology, with simulated information, are presented in the sixth section and the main conclusions and recommendations are found in the seventh section.

Additionally, in the Annexes section there is the Guide for the Supervision of the Prevention and Management of ML/FT Risk System in Correspondent Banking and ML/FT Risk Assessment Methodology for Correspondent Banking Relationships and two formats: for requesting for information to the supervised banks, and for elaborating a database of foreign banks.

II. THEORETICAL FRAMEWORK

CORRESPONDENT BANKING

There is consensus in the literature on the definition of correspondent banking as a bilateral arrangement that involves the provision of an account by one bank (the correspondent bank) to another bank (the respondent bank) used for the execution of third party payments and trade finance, as well as its own cash clearing, liquidity management and short-term borrowing or investment needs in a particular currency (The Wolfsberg Group, 2014; FATF, 2016). The capability to perform these services removes the need for banks to establish a physical presence in different jurisdictions and supports financial inclusion.

It is important not to confuse the exchange of SWIFT codes with correspondent banking because, unlike correspondent banking, the exchange of SWIFT codes does not necessarily involve an arrangement between the parties. SWIFT code is only used to identify the financial institution to which the bank wants to send the transfer message.

Correspondent banking relationships play a vital role in economic development and trade, they also allow smaller banks to offer payment infrastructures as well as offer and settlement of payment instruments such as letters of credit. That is why several institutions around the world investigate their associated risks and the best way to mitigate them.

In a correspondent banking relationship, the correspondent bank performs transactions on behalf of the respondent bank's customers with no further information about the customer than that provided by the respondent bank. For that reason, these kind of relationships are potentially vulnerable to money laundering and terrorist financing (ML/FT) risks. The complexity of this is important as banks, depending on the jurisdiction in which they operate, have more or less rigorous anti-money laundering compliance programs subject to different regulations, so the information gathering of the customer will differ. Therefore, the correspondent bank must perform a risk assessment before engaging into a new correspondent banking relationship.

The risk assessment of the correspondent bank should include the inherent risk resulting from the nature of the service provided, the characteristics of the respondent bank, the environment in which the respondent bank operates (geographic risk) and the respondent bank's risk management policies and procedures (BIS, 2017).

Regarding the risks mentioned before, the Financial Action Task Force (FATF) in its Recommendation 13 requires financial institutions to gather sufficient information about a respondent institution to fully understand the nature of the respondent's business, reputation and the quality of its supervision, including whether it has been subject to a ML/FT investigation or regulatory action and to assess the respondent institution's AML/CFT controls. The recommendation also requires additional measures to be applied in addition to performing the customer due diligence (CDD), and enhanced due diligence (EDD) measures in FATF Recommendation 10 for high risk customers. And prohibits engaging in or continuing a correspondent banking relationship with a shell bank.

In order to mitigate these risks, it is recommended to (i) conduct ongoing due diligence on the respondent bank, including periodical reviews of the CDD information on the respondent bank; (ii) apply an ongoing transaction monitoring; (iii) interplay with FATF recommendations 6, 7 and 16; (iv) fully understand the respondent bank's risk management policies and procedures; (v) apply an ongoing communication and dialogue; (vi) have clear terms governing the correspondent banking relationship; and (vii) adjust the mitigation measures to the risk' evolution (FATF, 2016; BIS, 2017). It is worth noting that all these points depend on the level of risk associated with the correspondent banking relationship and the nature of correspondent banking services provided.

In the same way, The Wolfsberg Group proposes principles that constitute a global guidance for the establishment and maintenance of correspondent banking relationships. These principles define guidelines that institutions must follow in order to have a better understanding of the ML/FT prevention systems available to their correspondents and to be more certain about the operations that are channeled through correspondent banking. The principles are the following: (i) responsibility and oversight; (ii) risk based due diligence; (iii) enhanced due diligence; (iv) monitoring and reporting of suspicious activities; and (v) integration with the Anti-Money Laundering Program (The Wolfsberg Group, 2014).

The Basel Committee on Banking Supervision proposes some recommendations for correspondent banking. These are associated with Know Your Customer (KYC) applications, the use of Legal Entity Identifier (LEI), information exchange initiatives, payment messages and the use of LEI as information in payment messages. The first recommendation mentions that the use of KYC applications by the respondent bank and the correspondent bank could serve as an effective means of reducing the compliance burden on the customer's due diligence requirements for the bank. In addition, standardizing the information would then serve to reduce the costs associated with the customer's due diligence. The second recommendation proposes the promotion of the use of LEI for all banks with correspondent banking operations as a means of identification that must be provided in KYC applications and information exchange agreements. The third recommendation states that FATF provide greater clarity on the extent to which banks need to apply KYCC (Know Your Customer's Customer) and continue to address the obstacles to information exchange in order to identify best practices. The fourth recommendation mentions that banks must decide individually which payment method best meets their needs and those of their customers and agree with other banks involved in the method to be used. The last recommendation suggests the use of LEI as additional information in the payment messages (BIS, 2016).

DE-RISKING PHENOMENON

In recent years, some banks have preferred to withdraw from their correspondent banking relationships, instead of managing risks, due to the new macroeconomic environment and changes in the regulation, notably regarding more rigorous prudential requirements, economic and trade sanctions, AML/CFT and tax transparency; thus directly affecting emerging economies and low-income countries. This phenomenon is called de-risking.

There is no consensus in the literature on the definition of de-risking. On one hand, this term covers a set of actions done by the banks to effectively avoid business and reputational risk altogether. This risk avoidance

would typically occur on a wholesale basis, without a case-by-case assessment of the risk associated with individual customers, or the country or region involved, or as a result of an analysis indicating that the business relationship as a whole was no longer profitable (FMI, 2016; FATF, 2016). On the other hand, this term has been used more broadly to refer to any form of withdrawal of financial services (FMI, 2016; ASBA, 2017; Haley, 2018).

As a complex issue, de-risking is driven by a combination of many factors such as information asymmetries, low return business lines for correspondent banking, reputational and liability risks, changes in banks' financial risk appetites, financial penalties imposed by supervisory and law enforcement authorities, increased compliance costs associated with implementing conflicting regulatory requirements, and heightened standards for AML (ASBA, 2017; FATF, 2016; FCA, 2016). The drivers of de-risking are different for each bank as some consider some factors to be relevant, while others are not.

The withdrawal of correspondent banking has different effects. In the first instance, the effects are economic. The loss of CBRs could have significant costs including lower exports and imports, the loss of foreign direct investment (FDI) and the loss of money transfer organizations (MTO). For countries dependent on remittances, the loss of MTO services can be particularly debilitating for the economy as higher costs for transferring money has a direct impact on the poorest households for whom remittances are a critical source of income, driving licit transactions into the shadows and hindering the achievement of AML and CFT goals (Haley, 2018; ASBA, 2017; FATF, 2016; FMI, 2016).

In the second instance, de-risking can decrease financial inclusion and pressure on small banks to take high risk customers because it provides incentives inefficiently to group customers to prevent potential sanctions; promote use of non-regulated finance, Fintech and Shadow banking and create a regulatory paradox as the higher compliance and regulation requirements aimed at reducing and preventing ML/FT activities are provoking de-risking, which pushes transactions to less regulated and monitored markets (Haley, 2018; ASBA, 2017; FATF, 2016; FMI, 2016).

As a complex issue involving several elements, there is no single solution to the problem of de-risking. However, different institutions point out the need to identify measures to mitigate costs and avoid unintended consequences. This requires a focus on technology to reduce compliance costs and to increase and enhancement of LEI and KYC utilities standardization to facilitate compliance; centralized regional and / or national databases; the consolidation of CBRs through major correspondent banks and nesting, and to regulate adoption of Fintech as it can be a complement to correspondent banking services if handled in a responsible way (ASBA, 2017; Haley, 2018).

Also, it is recommended, before withdrawing from correspondent banking relationships, to consider additional measures such as limiting the services provided, real-time monitoring, sample testing of transactions or on-site visits, and creating a contingency plan to mitigate the risk of a major disruption to cross-border financial flows if the country is affected by de-risking (BIS, 2017; FMI, 2016).

III. SUPERVISORY TOOLKIT PROPOSAL

The main reason why there are cases of de-risking is associated with weakness in the prevention and management of a ML/FT risks system of respondent banks. In order to prevent de-risking, this paper proposes the use of a Supervisory Toolkit on Correspondent Banking. Thus, banks' supervisors will have tools to improve the supervision of this kind of operations; also taking into account that the capacity of the supervisor represents a factor when applying de-risking.

The Toolkit is comprised of two tools: (i) a Guide for the Supervision of the Prevention and Management of the ML/FT Risk System in Correspondent Banking and (ii) a ML/FT Risk Methodology Assessment for Correspondent Banking Relationships.

(i) The Guide aims to assess the ML/FT risks management associated with the correspondent banking relationships of the supervised banks, based on the standards of international organizations specialized in the field, in this case the FATF and the Wolfsberg Group. The Guide has two specific objectives and thirteen procedures that seek to cover the entire spectrum of correspondent banking relationships, from the agreement between the banks to the monitoring of the transactions carried out by this means. This paper establishes the detail of how each procedure must be performed, the information to request and the criteria to evaluate.

The application of the Guide should result in the identification of the main weaknesses of the supervised banks in their correspondent banking relationships, with the purpose of recommending improvement actions in their ML/FT risks management.

(ii) The Methodology aims to establish the guidelines to determine the level of ML/FT risks of the supervised banks according to their correspondent banking relationships with foreign banks. The Methodology is based on the evaluation of the level of risk of the foreign banks, whether correspondent or respondent, through seven variables related to the exposure of the bank, and management of ML/FT risks. Then the level of risk exposure of the local bank is measured given the proportion of relationships with high risk banks. Added to the result of the exposure is the rating of ML/FT risks management that the banks performs to its correspondent banking relationships, which is measure, in part, by the application of the Guide.

The application of the Methodology should result in the identification of the supervised banks with a higher level of risk given their correspondent banking relationships, so that the supervisor can develop supervisory activities aimed at the banks in which a greater risk is detected, such as an increase in the frequency of on-site evaluation or off-site monitoring. The Methodology also helps to identify foreign banks with higher levels of risk and with which local banks they maintain relationships; as well as useful statistics.

In addition, the Toolkit includes two formats in order to facilitate the application of the Methodology, the first is a standardized format to Request for Information about banks' correspondent banking relationships (see Annex N° 3); the second is a template for the Database of foreign banks (see Annex N° 4). The first format includes characteristics of the foreign bank such as their name, SWIFT code, and jurisdiction, among others. The second

format proposes a template with the main variables of foreign banks that the supervisor needs to know in order to apply the Methodology.

IV. DATA

In Peru, the competent authority that oversees compliance with the provisions on ML/FT risk prevention by banks is the Superintendence of Banks, Insurance and Pension Fund Administrators (SBS, by its acronym in Spanish). The specialized department that exercises such supervision is the ML/FT Risk Supervision Department (DSRLAFT, by its acronym in Spanish).

One of the most important tools available to the DSRLAFT for the development of off-site supervision, and through which information is obtained from the correspondent banking relationships of supervised banks, is the computer system called the Biannual Report of the Compliance Officer (ISOC, by its acronym in Spanish), which is filled out by the supervised entities on the SBS webpage.

The SBS defines the content of the ISOC, which provides information about the exposure and management of ML/FT risks. For example, the bank is requested to attach all of its internal ML/FT risk management policies, report the statistics of unusual and suspicious activities reported to the Financial Intelligence Unit (FIU) of Peru, and complete statistical reports of its presence in the geographical areas of the country, the types of products it offers and the characteristics of its customers.

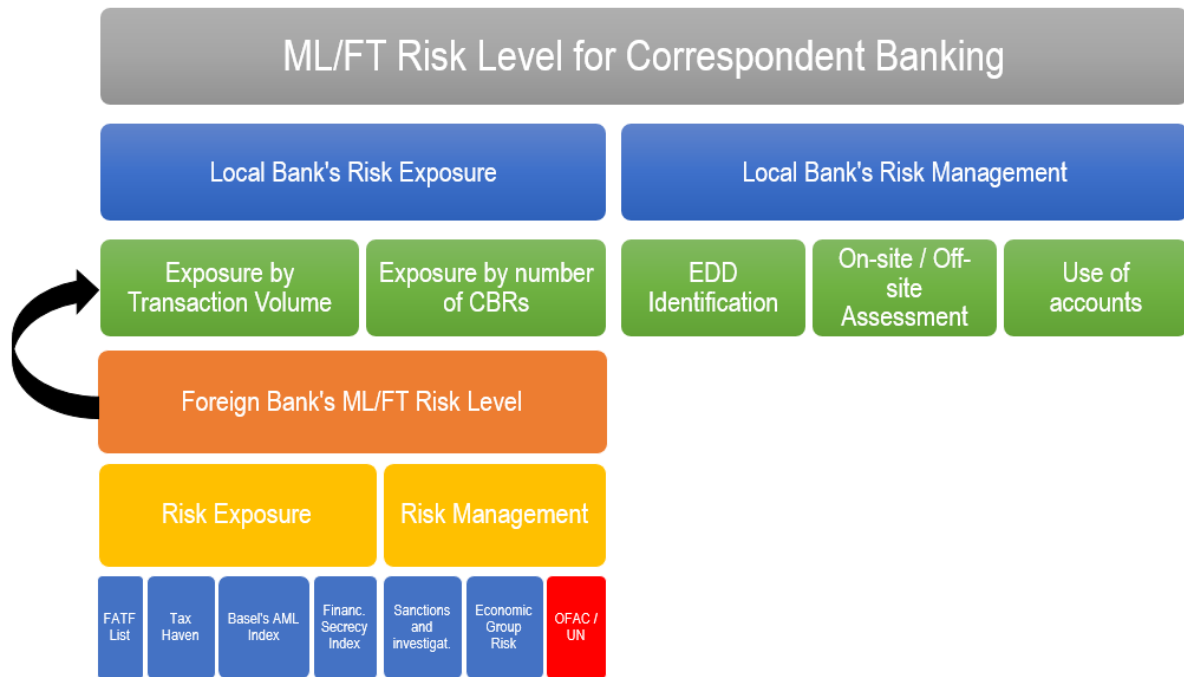
Within the ISOC, the bank is requested to complete a specific format on its correspondent banking relationships, whether the local bank acts as a correspondent or as a respondent of a foreign bank (see Annex N° 3), this includes information banks with which a relationship is maintained despite the fact that no transactions have been carried out in the reported period. The format asks banks to indicate the name of the foreign bank, its SWIFT code or equivalent if they use another messaging system (taking into account that the SWIFT system is more used for this type of operations) and the volume of transactions performed with that bank, both receiving and sending.

Additionally, banks must indicate if the correspondent or respondent bank is subject to enhanced due diligence by the local bank, as well as explaining the reasons that justify this situation. Finally, the bank is asked if the foreign bank has an account in the Peruvian bank, and if the Peruvian bank has an account in the foreign bank. This allows learning whether the correspondent banking relationship is bilateral, that is, that both provide the correspondent service, or unilateral, determining which bank is acting as a correspondent.

Each semester, the ISOC presents accumulated information for the corresponding period. The deadline for delivery is 15 days after the approval by the Board of Directors, which must be informed within 30 days after the end of the corresponding semester. In this way, the Superintendence prepares two reports, the results of which are used in the planning and implementation of supervisory activities during the year.

V. METHODOLOGY

Illustration 1: Methodology



5.1. Local Bank's ML/FT Risk Exposure

5.1.1 Foreign Bank's ML/FT Risk Measurement

The extent in which a bank is exposed to the ML/FT risks by its correspondent banking relationships directly depends on the ML/FT risks to which the foreign bank, with which the local banks interacts, is exposed. Thus, the first step to assess the risk of the local bank, is to measure the risk of the foreign bank, according to its particular characteristics, so it is necessary to define the variables of both risk exposure and risk management. Here a first limitation arises, since the foreign bank is an entity that is not directly supervised by the local supervisor, the latter cannot know all its characteristics such as the type of operations it performs, the characteristics of its customers and the areas in which it operates in its jurisdiction; or, if these characteristics can be known, it is costly to conduct an in-depth investigation of each of these banks, given that there could be a multiple number of correspondent banking relationships that may exist with local banks. In the same way, it is difficult to know the quality of the ML/FT risks management, unless this is obtained directly from the respective banking supervisors; however, this information could be biased. In that sense, the variables proposed in this methodology are characteristics of the bank that can be verified by public means, so that the application of the methodology is cost-efficient and not distorted by introducing information that reduces homogeneity between what is known of each foreign bank.

5.1.1.1. Foreign Bank's Risk Exposure

FATF listing

On the side of risk exposure, the risk factor that is easier to identify, and that usually has a greater weight when there is no information on the risk management of the bank, is the geographical area in which the foreign bank operates. For this, the methodology uses four variables. The first of these is the inclusion of the jurisdiction in the list of countries considered as non-cooperative by the FATF, a variable that must take into consideration the different gradations that it has: blacklist, gray list and intensified monitoring. If the jurisdiction is listed, it is understood that the FATF has expressed concern about the preventive measures taken by the country to prevent money laundering and the financing of terrorism; usually the identified deficiencies in preventive measures are attributed to the financial institutions and their respective supervisors. Thus, this situation means a greater exposure for the foreign bank.

Tax Haven Condition

The second variable refers to whether the jurisdiction is considered a country of low or no taxation, taking into account that said condition increases the risk of criminal activities such as tax evasion. These jurisdictions can be defined by the country's tax regulations, in the case of Peru, the Regulation of the Income Tax Law (Decreto Supremo No. 122-94-EF) which establishes a list of 44 jurisdictions under said condition. If the country does not have such a list, they can use those prepared by other organizations such as the OECD or the European Union.

Financial Secrecy Index

For the third and fourth variables of the geographical area component, the methodology is leveraged on two indicators calculated by international organizations. The first one is the Financial Secrecy Index, "The Financial Secrecy Index ranks jurisdictions according to their secrecy and the scale of their offshore financial activities. A politically neutral ranking. It is a tool for understanding global financial secrecy, tax havens or secrecy jurisdictions, and illicit financial flows or capital flight." (Tax Justice Network, 2019). Prepared by the Tax Justice Network, it uses 20 variables, among which are: registration and disclosure of final beneficiaries, bank secrecy, tax transparency, and information exchange, among others.

Basel's AML Index

The other index used, and the last variable of the geographical area component, is the Basel's Anti Money Laundering Index. "The Basel Anti-Money Laundering Index is an independent ranking and risk rating tool that assesses money laundering and terrorist financing (ML/FT) country risk around the world" (Basel Institute on Governance, 2018). The index uses the following variables: quality of AML/CFT framework, corruption risk, financial transparency and standards, public transparency and accountability, and political and legal risk.

Although both indexes measure similar characteristics of the jurisdictions, even sharing some variables for their calculation, it is advisable to use both these indexes in order to obtain a more homogeneous rating.

Both indexes have as a limitation the scope of the countries evaluated, in the case of the Financial Secrecy Index, it has assessed 112 jurisdictions, while Basel's AML Index has done the same with 129 jurisdictions³. If the risk of a jurisdiction that is not in any of these indexes is being evaluated, the methodology assigns an average level of risk.

Table 1: Risk Exposure Variables

ML/FT Risk Exposure	
Variable 1	FATF listing
Variable 2	Tax haven condition
Variable 3	Financial Secrecy Index
Variable 4	Basel's AML Index

5.1.1.2. Foreign Bank's Risk Management

The risks to which the jurisdiction is exposed are not under the control of the bank, but they are part of the environment in which it operates and must be properly managed. Thus, the methodology establishes ML/FT risk management variables, given that it would not be accurate to qualify a bank as high risk only because of the conditions in its environment, but it also takes into account the information that is known on how it mitigates the risks.

Sanctioned or investigated condition

The first variable used to measure the quality of the risk management of the foreign bank is the condition of whether it has been sanctioned, or is being investigated by the competent authorities, for deficiencies in the application of AML/CFT measures. Although not in all jurisdictions the information of the sanctions is made known by the competent authorities, which could represent a limitation, it is considered that this variable is one of the few that allows us to approach the management of the bank, without conducting a direct supervision. However, in most of the countries in which the correspondent banks operate, the sanctions information is communicated by the authorities, which facilitates their access through public sources. In some regulations, the bank is also obliged to inform the sanction to the public, as is the case of significant events in the securities market.

To avoid overestimating the risk of a bank that has been sanctioned, considering that it could have corrected the deficiencies that led to the sanction, it is recommended to use public sources that are less than 5 years old.

Economic Group Risk

Taking into account that many of the correspondent banking operations are carried out with the intervention of financial institutions of the same group, acting as originators or intermediaries of the transactions, as well as the fact that banks must share common AML/CFT policies at the group level; It has been considered appropriate to

³ The public version has the evaluation of 129 jurisdictions, while the "Expert Edition" of the report has 203.

evaluate the risk of the foreign bank derived from the risks presented by the other members of its economic group. To measure this variable, the partial calculation of the banks belonging to the same group is used, taking into account the other variables already qualified. In this way, all the banks of an economic group have a rating given by the average of the partial rating of each bank in the group, obtained by the risks linked to the geographical areas in which they operate, the sanctions or investigations regarding AML/CFT deficiencies, and if they are included the lists issued by the United Nations Security Council or the Office of Foreign Assets Control.

UN and OFAC listing

The last variable linked to the management carried out by the foreign bank is its inclusion in the lists prepared by the UN or OFAC. Although this situation may be unlikely, the variable is used because of the impact it could have on the level of ML/TF risks to which the local bank is exposed. Considering the low probability that a bank operates with this type of foreign bank, the variable does not have a weight in relation to the other variables, since, in general, it would only serve to reduce the level of risks of each bank. Not having a weight, however, if the bank is listed, the methodology contemplates that the level of risk is automatically the highest possible, without considering that the rest of the variables could grant a low rating. If this situation is detected, the supervisor must apply prudential measures that go beyond this methodology.

5.1.1.3 Foreign Bank's Risk Level

To measure the level of ML/FT risk of the foreign bank, the 4 exposure and 3 management variables described above are used, counting each one of them, except for the one referred to the inclusion in the UN or OFAC listings, and a weight that measures the degree of relative importance with respect to the other variables. In this way, each foreign bank will have a risk rating between low, medium and high.

5.1.2. Local Bank's Risk Exposure Measurement

From the application of the foregoing, each foreign bank, with which the local banks maintain correspondent banking relationships, obtains a level of risk, which is given by the exposure to ML/FT risks and its management. In this way, the next step is to assess how much the local bank is exposed given the relations it maintains with these foreign banks. For this, two measurements are made, one by the volume of transactions carried out with high-risk foreign banks, and the other by the proportion of high-risk foreign banks in relation to total correspondent relationships. The purpose of performing two measurements is to avoid the overestimation of one of them. For example, a bank may maintain correspondent relationships with a majority of high-risk banks, leading to the conclusion that the level of exposure is high, however, it channels most of its transactions through a low-risk bank.

5.1.2.1. Risk Exposure by Correspondent Transactions Volume

By having information on the volume of transactions that are channeled through each foreign bank and its level of ML/FT risks, it is possible to determine the proportion of transactions that are carried out with high, medium or low risk banks. The methodology contemplates the application of two thresholds. The local bank is considered

to have a high level of exposure to ML/FT risks when 30% or more of its correspondent transactions are made with high-risk foreign banks; If 70% of the correspondent transactions are carried out with low-risk foreign banks, then the exposure level is also low; In case neither of the two conditions is met, the exposure level is medium.

Conditions	Exposure Level
<i>Transactions Volume of Low Risk Banks (%) > 70%</i>	Low
<i>Transactions Volume of High Risk Banks (%) ≥ 30%</i>	High
<i>Any other condition</i>	Medium

5.1.2.2. Risk Exposure by number of correspondent relationships

The second measurement is made using the proportions of foreign banks of high, medium and low risk, including those foreign banks with which no transactions have been carried out during the analysis period, but there is a current correspondent agreement, considering that there is a latent risk that can occur at any time. Similar to the previous measurement, the local bank is considered to have a high level of exposure to ML/FT risks when 30% or more of its correspondent relationships are established with high-risk foreign banks; If 70% of the correspondent relationships are established with low-risk foreign banks, then the exposure level is also low; In case neither of the two conditions is met, the exposure level is medium.

Conditions	Exposure Level
<i># of low risk banks (%) > 70%</i>	Low
<i># of high risk banks (%) ≥ 30%</i>	High
<i>Any other condition</i>	Medium

5.1.2.3. Local Bank's Total Risk Exposure

After obtaining the exposure measurements by volume of transactions and by the number of correspondent relationships, both factors are used to determine a total exposure level. The local bank is considered to have a high level of exposure, if one of both measurements is high risk and the other is medium or high risk. It is only considered low risk when both measurements are low risk. In any other case, it is considered medium exposure.

Exposure:	By transactions volume			
	Risk:	Low	Medium	High
By number of relationships	High			
	Medium			
	Low			

5.2. Local Bank's ML/FT Risk Management

The next step, after having obtained the total exposure of the local bank by its correspondent banking relationships, is to rate the quality of the management of the local bank's ML/TF risks, specifically, how it

mitigates the risks related to such relationships. Thus, the methodology establishes 3 management variables to be evaluated by the supervisor, one of them through the application of the proposed Supervision Guide, and the other two, with the information reported by each bank in the Format (Annex N° 3).

5.2.1. ML/FT Risk Management Variables

On-site / Off-site assessment results

From the application of the Supervision Guide on Correspondent Banking (Annex N° 1), the supervisor must be able to rate the quality of the management of the local bank with respect to its correspondent banking relationships. For this, 4 levels of compliance have been considered, from higher to lower, as follows: "Satisfactory", "Adequate", "Insufficient" and "Deficient".

This variable is considered to be the most important, given the direct relationship between the bank and the supervisor, which is empowered to evaluate both the procedures and policies, and the effectiveness of their application on-site.

If an on-site supervision has not been carried out in which the Guide can be applied, or it has been carried out a long time ago, in which case the results of the supervision do not correspond to the current situation of the supervised bank, it is recommended to carry out an off-site evaluation, as far as possible, of the procedures described in the Guide. In this way, the procedures and policies contained in internal normative documents should be evaluated, such as: the minimum information requested from the foreign bank, the de-risking procedures, the treatment of banks subject to enhanced due diligence, among others. The effectiveness application of the policies and procedures should be avoided, since these, in most cases, can only be assessed on-site.

Identification of banks subject to enhanced due diligence

From the information provided by the banks, the supervisor can identify those foreign banks that should be subject to the enhanced due diligence by any of the causes described in the Guide. In this regard, the supervisor is not necessarily able to identify all the cases for which the bank should subject to EDD. For example, if downstream correspondent banking operations are carried out or if a PEP is part of the shareholding structure, then only the local bank can know about these operations or the structure of the foreign bank if it has required it as part of the due diligence information. In that sense, in order to avoid an asymmetric information problem, the methodology establishes as a single criterion for the enhanced due diligence condition of the foreign bank if it has been sanctioned or is being investigated for ML/FT reasons.

Both the local bank and the supervisor are in the same situation in learning, through public sources, if the foreign bank has been sanctioned by a competent authority. Thus, if the local bank has not identified such a situation, it would not be able to apply enhanced due diligence measures, which has a negative impact on the quality of ML/FT risk management.

Use of accounts in the correspondent relationship

Although correspondent relationships are usually bilateral, there are many cases in which only the local bank or the foreign bank acts as a correspondent and the other as a respondent. To identify these situations, based on the information provided by the banks, the holding of accounts between the banks is observed. When both banks have accounts in the other, it is observed that there is a bilateral correspondent relationship, this situation would represent a higher level of risk, since both act in favor of the other's customers. In the event that the holding of accounts is unilateral, for the supervisor, who is evaluating the risks of ML/FT of its' supervised banks, the most risky situation is that it is the foreign bank who owns an account at the local bank and that it acts as the correspondent. It is less risky that it is the foreign bank who acts as a correspondent for the respondent local bank. In cases where there is no holding of an account by any of the banks, there may still be a correspondent relationship, as long as the transactions carried out are only active (trade finance, letters of credit), which reduces the risks of ML/FT.

In this way, the bank's willingness to maintain accounts in the foreign bank and open accounts in the name of said bank is evaluated, which is considered as a risk management variable. Thus, there would be situations that would imply a higher level of risk. However, it should be noted that the use of accounts is essential in correspondent relations. Therefore the methodology does not assign a significant weight to this variable.

5.2.2. ML/FT Risk Management Assessment

After evaluating each of the ML/TF risk management variables, these are added according to a weight for the relative importance they have in relation to the others. A higher weight is assigned to the on-site/off-site Assessment, given that it is considered to be the most accurate measurement of the bank's management to mitigate the exposure to ML/FT risks by the correspondent banking relationships. Thus, to determine the final management rating of each of the local banks, the same 4 levels of compliance used for the variable described above are used: "Satisfactory", "Adequate", "Insufficient" and "Deficient".

5.3. ML/FT Risk Level by correspondent banking

To conclude with the assessment of the level of ML/FT risks by correspondent banking, both the exposure and the management of ML/FT risks of each bank must be added. For this, a matrix is used to make the combinations between exposure levels and the quality of management. A Deficient risk management is considered to greatly amplify the bank's exposure level. An Insufficient management also amplifies the risks, but to a lesser extent than a Deficient management. An Adequate risk management only allows the level of risk to be maintained; while only a satisfactory management allows risk exposure to be mitigated.

		Exposure Level		
		Low	Medium	High
Quality of Risk Management	Deficient			
	Insufficient			
	Adequate			
	Satisfactory			

VI. APPLICATION IN OF THE METHODOLOGY

With the aim of not revealing sensitive information about Peruvian banks, it was decided to use fictitious data both in the banks' names and for the data of the corresponding variables used in the Methodology in order to apply the Toolkit. All information in this section was simulated for the purpose of showing the Methodology's application. It should be noted that the DSRLAFT has used these tools since 2017.

With information for the second semester of the 2018, relevant information was obtained about the number of correspondent banking relationships that are maintained by all local banks, jurisdictions of the foreign banks, volume of transactions in US dollars per month between July and December 2018 and relevant information about the ML/FT risk management of the local bank.

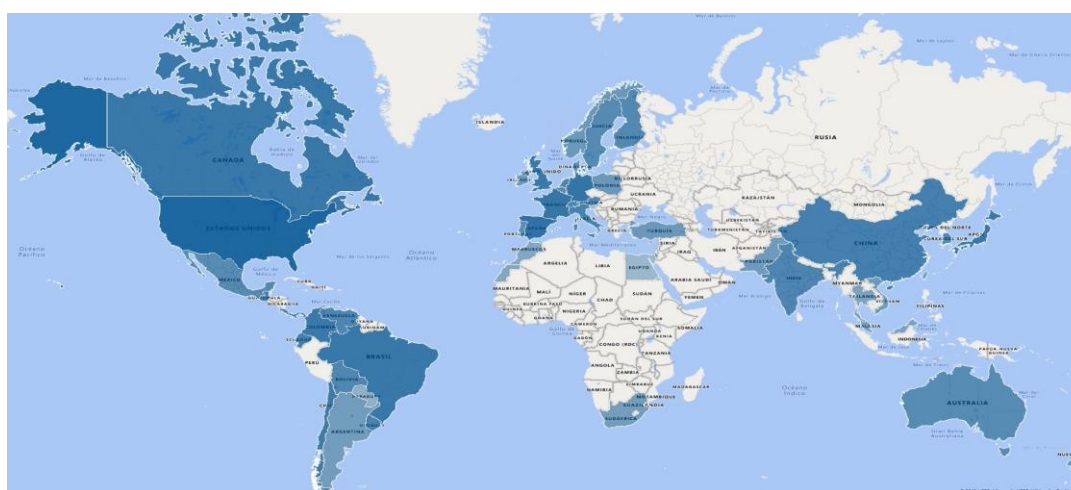
As shown in Table 2, for the second semester of the 2018, 12 local banks participated, maintaining correspondent banking relationships with a total of 387 foreign banks distributed in 57 jurisdictions and 204 economic groups. In addition, the total volume of transactions between July and December was US\$ 55,279,250,190.90.

Table 2: Characteristics of correspondent banking operations

Local banks	Foreign banks	Jurisdictions	Economic group	Volume in US\$
12	387	57	204	55,279,250,190.90

Depending on the volume of operations, Figure 1 shows the jurisdictions with which local banks have correspondent banking relationships. Thus, in this case, most of the volume of operations is in the Americas, specifically in the United States.

Figure 1: Map of correspondent banking relationships



Similarly, Table 3 presents the top 5 jurisdictions according to the volume of transactions for the period analyzed. They show that approximately 78% of the total volume of operations are carried out with the United States; followed by Spain, which represents approximately 7% of the total and Germany, 4.5%.

Table 3: Top 5 jurisdictions according to the volume of CBRs in US\$

Jurisdiction	Volume in US\$
United States	35,693,235,323.49
Spain	4,055,785,777.23
Germany	2,514,651,444.28
France	1,879,370,502.56
Canada	1,426,764,255.20
Total	55,279,250,190.90

In accordance with the variables established in the Methodology (Annex N° 2), it was found that the local banks have correspondent banking relationships with 67 high level of risk foreign banks, 60 medium level and 260 low level (Table 4). Also, the transactions volume in dollars was determined according to the level of risks of foreign banks; such that, the volume of transactions with high level of risk foreign banks represents 51% of the total volume, followed by the volume of transactions with medium level of risk banks (29%).

Table 4: Volume of the CBRs in US\$ according to the level of risks foreign banks

Level of risk	Number of foreign banks	Volume in US\$
High	67	28,158,864,294.27
Medium	60	11,124,891,169.64
Low	260	15,995,494,726.99
Total	387	55,279,250,190.90

Based on the foregoing, the calculation of the level of ML/FT risks exposure of the local banks by the number of correspondent banking relationships was made. Hence, from the local banks with a medium level of risk exposure, only two banks with high level of risk exposure and one with low level (Table 5).

Table 5: Level of ML/FT risk exposure by the number of CBRs

Local banks	N° high risk level foreign banks	%	N° medium risk level foreign banks	%	N° low risk level foreign banks	%	Level of risk exposure
Bank A	0	0%	0	0%	2	100%	Low
Bank B	12	26%	10	21%	25	53%	Medium
Bank C	9	41%	5	23%	8	36%	High
Bank D	0	0%	2	40%	3	60%	Medium
Bank E	1	20%	3	60%	1	20%	Medium
Bank F	2	11%	5	26%	12	63%	Medium
Bank G	0	0%	1	50%	1	50%	Medium
Bank H	3	25%	4	33%	5	42%	Medium
Bank I	27	18%	26	17%	96	64%	Medium
Bank J	10	38%	8	31%	8	31%	High
Bank K	50	18%	47	17%	180	65%	Medium
Bank L	8	20%	9	23%	23	58%	Medium

On the other hand, the calculation of the level of ML/FT risks exposure by transactions volume of correspondent banking was made and found five local banks with medium level of risk exposure, four with high exposure level and three with low level of risk exposure (Table 6).

Table 6: Level of ML/FT risks exposure by CBRs volume

Local banks	Transactions volume with high risk level foreign banks	%	Transactions volume with medium risk level foreign banks	%	Transactions volume with low risk level foreign banks	%	Level of risk exposure
Bank A	-	0%	-	0%	993,883.58	100%	Low
Bank B	5,179,050.43	1%	554,426,346.84	98%	8,575,000.00	2%	Medium
Bank C	16,221,780,537.87	88%	26,918,495.27	0%	2,109,742,769.99	11%	High
Bank D	1,444,437,450.00	38%	2,323,110,169.00	61%	56,373,940.00	1%	High
Bank E	20,885.97	0%	243,712,071.88	99%	2,931,217.58	1%	Medium
Bank F	-	0%	40,891,885.81	32%	87,907,256.21	68%	Medium
Bank G	2,477,918,606.58	29%	2,562,760,368.49	30%	3,628,259,819.63	42%	Medium
Bank H	145,128,918.65	14%	232,644,216.21	23%	627,538,037.77	62%	Medium
Bank I	-	0%	109,208,186.88	12%	839,239,328.23	88%	Low
Bank J	2,339,220,844.77	35%	2,364,442,429.26	35%	1,991,455,668.99	30%	High
Bank K	-	0%	-	0%	30,411,805.00	100%	Low
Bank L	5,525,178,000.00	37%	2,666,777,000.00	18%	6,612,066,000.00	45%	High

Consequently, it is calculated, through the risk matrix, the total ML/FT risks exposure level by correspondent relationships of the local banks. The result is detailed in Table 7. In sum, seven banks with medium total ML/FT risks exposure level, four banks with high and one with low level of total risks exposure were found.

Table 7: Total ML/FT risks exposure level of local banks

Local banks	Exposure by number of CBRs	Exposure by volume	Total exposure level
Bank A	Low	Low	Low
Bank B	Medium	Medium	Medium
Bank C	High	High	High
Bank D	Medium	High	High
Bank E	Medium	Medium	Medium
Bank F	Medium	Medium	Medium
Bank G	Medium	Medium	Medium
Bank H	Medium	Medium	Medium
Bank I	Medium	Low	Medium
Bank J	High	High	High
Bank K	Medium	Low	Medium
Bank L	Medium	High	High

On the other hand, for the second stage of the assessment of ML/FT risks by correspondent banking relationships of the local bank, it is necessary to calculate the variables established in the Methodology (Annex N° 2). Thus, starting from the results of the evaluation of the two objectives indicated in the Guide for the Supervision of the Prevention and Management of ML/FT Risk System in Correspondent Banking (Annex N° 1), the results are shown in Table 8.

Table 8: On-site / Off-site assessment results

Local banks	On-site / Off-site assessment results
Bank A	3
Bank B	2
Bank C	3
Bank D	2
Bank E	2
Bank F	2
Bank G	2
Bank H	4
Bank I	4
Bank J	3
Bank K	4
Bank L	3

Then, for the calculation of the second variable “Identification of banks subject to enhanced due diligence (EDD)”, starting from the information provided by the banks and the database of banks sanctioned or investigated in the last 5 years (Annex N° 4), is possible to determine the percentage of banks duly identified and registered in the Enhanced Due Diligence. Thus, observe that, for the most part, local banks have not identified and, therefore, not correctly registered in the Enhanced Due Diligence sanctioned or investigated foreign banks. Only four local banks have fully identified the banks subject to the Enhanced Due Diligence (Table 9).

Table 9: Identification of banks subject to the Enhanced Due Diligence

Local banks	N° sanctioned or investigated foreign banks in EDD	Total of sanctioned or investigated foreign banks	% of identified banks	Management score
Bank A	18	18	100%	4
Bank B	0	53	0%	1
Bank C	0	14	0%	1
Bank D	32	97	33%	1
Bank E	3	4	75%	2
Bank F	0	7	0%	1
Bank G	5	22	23%	1
Bank H	0	7	0%	1
Bank I	0	0		4
Bank J	0	2	0%	1
Bank K	17	17	100%	4
Bank L	1	1	100%	4

Finally, the calculation of the variable “Use of accounts in the correspondent banking relationships” is performed, the result is detailed in Table 10. So, for the most part, local banks usually do not have an account in their correspondents but they do let these have accounts in their banks. Likewise, local banks usually have correspondent relationships without opening accounts, predominantly active operations.

Table 10: Use of accounts in the correspondent banking relationships

Local banks	Management score
Bank A	2.20
Bank B	4
Bank C	2.00
Bank D	4
Bank E	2.20
Bank F	3.94
Bank G	3.85
Bank H	2.20
Bank I	1.98
Bank J	2.20
Bank K	3.74
Bank L	4

From the previous results, the final management score and the corresponding qualification are calculated, according to the Methodology (Annex N° 2), and in Table 11 are presented the results of the quality of the Risk Management of ML/FT risks of the local banks. Thus, local banks, for the most part, have an Insufficient risk management rating, only two banks have an Adequate rating and three have a Satisfactory rating.

Table 11: Total score of ML/FT Risk Management of local banks

Local banks	On-site / Off-site assessment results	Identification of banks subject to the Enhanced Due Diligence	Use of accounts	Final management score	Qualification
Bank A	3	4	2.20	3.22	Adequate
Bank B	2	1	4	1.93	Insufficient
Bank C	3	1	2.00	2.3	Insufficient
Bank D	2	1	4	1.91	Insufficient
Bank E	2	2	2.20	2.32	Insufficient
Bank F	2	1	3.94	1.89	Insufficient
Bank G	2	1	3.85	3.09	Insufficient
Bank H	4	1	2.20	3.82	Adequate
Bank I	4	4	1.98	2.75	Satisfactory
Bank J	3	1	2.20	3.82	Insufficient
Bank K	4	4	3.74	3.37	Satisfactory
Bank L	3	4	4	1.93	Satisfactory

Finally, based on the risk matrix, the level of risk of local banks is calculated (Table 12). In this way, it is concluded that there are six banks with a medium risk level, three with a low risk level and three with a high risk level.

Table 12: Local Banks' risk level

Local Banks	Exposure level	Management Qualification	Local banks' risk level
Bank A	Low	Adequate	Low
Bank B	Medium	Insufficient	Medium
Bank C	High	Insufficient	High
Bank D	High	Insufficient	High
Bank E	Medium	Insufficient	Medium
Bank F	Medium	Insufficient	Medium
Bank G	Medium	Insufficient	Medium
Bank H	Medium	Adequate	Medium
Bank I	Medium	Satisfactory	Low
Bank J	High	Insufficient	High
Bank K	Medium	Satisfactory	Low
Bank L	High	Satisfactory	Medium

VII. CONCLUSIONS AND RECOMMENDATIONS

Throughout this work, the toolkit for correspondent bank supervision has been developed from the ground up. This toolkit provides instruments for on-site and off-site supervision, and is composed of the Guide for the Supervision of the Prevention and Management of ML/FT Risk System in Correspondent Banking (Annex N° 1) and the ML/FT Risk Assessment Methodology for Correspondent Banking Relationships (Annex N° 2).

On the one hand, the Guide develops the procedures that supervisors must carry out on-site in supervised banks in order to assess the quality of ML/FT risk management in correspondent banking relationships. The Guide is based primarily on FATF Recommendation 13 and the Wolfsberg Group Principles. It is important to emphasize the importance of applying this Guide even in an off-site way because it is essential to know the quality of the management of local banks to know their level of risk.

On the other hand, the Methodology, based on the assessment of the exposure and management of ML/FT risks of foreign banks, determines the total risk level of the banks supervised by their correspondent banking relationships. And it takes into consideration the characteristics of the foreign correspondent and respondent banks, and those of the local bank.

The proposed Toolkit represents a basis on which other supervisors can build tools that are more suitable for their needs. In that sense, the Toolkit is not intended to be a one-size-fits all formula, it should be adapted and improved. In principle, the inclusion of new variables could be evaluated or the weights of existing ones modified if it does not reflect the supervisor's perception of their importance, as well as incorporating or removing procedures from the Guide. Primarily, the supervisor must take into account the applicable regulations in their jurisdiction. In the same way, it is important to take into consideration the nature and complexity of the supervised banks.

The supervisor should not be content with just the application of the Methodology, but rather supervisory actions should be designed and implemented according to the risks level identified in their supervised banks, such as: increasing the frequency of on-site supervision, focusing supervisory efforts on identified deficiencies, and developing regulations according to risks, among others that may be determined

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XI. ANNEXES

ANNEX N° 1: GUIDE FOR THE SUPERVISION OF THE PREVENTION AND MANAGEMENT OF ML/FT RISK SYSTEM IN CORRESPONDENT BANKING

OVERALL OBJECTIVE

Assess the management of ML/FT risks associated with the correspondent banking relationships of supervised local banks, based on the standards of international organizations specialized in the field.

SPECIFIC OBJECTIVES

1. **Assess the process of identifying the ML/FT risks associated with correspondent banking relationships**

1.1 Assess if the bank has established due diligence procedures for the banks with which it intends or has established correspondent banking relationships.

1.2 Assess if the bank has established procedures to know in depth the business of the bank with which it intends or has established correspondent banking relationships.

1.3 Assess if the bank has established and implemented procedures for the evaluation of the ML/FT prevention system of correspondent or respondent banks.

1.4 Assess if the bank has policies to ensure that correspondent or respondent banks have a license issued by the competent authority in the jurisdictions in which they operate.

1.5 Assess if the correspondent banking agreements define the purpose of the correspondent relationship and the responsibilities for risk prevention and management of ML/FT of each participant.

1.6 Assess if the bank has implemented procedures that prohibit transactions with shell banks.

1.7 Assess if the bank has developed and implemented policies and procedures to identify and register in the enhanced due diligence the banks with which correspondent banking relationships are maintained.

2. **Assess the management of ML/FT risks associated with correspondent banking relationships**

2.1 Assess if the bank verifies the minimum information necessary in electronic transfers, from correspondent banking, before making them.

2.2 Assess the procedures for the continuous monitoring of the transactions made in favor of the customers of respondent bank.

2.3 Assess if the bank applies enhanced measures to correspondent or respondent banks subject to the enhanced due diligence.

2.4 Assess if the bank has procedures for the de-risking of correspondent or respondent banks for reasons related to ML/FT.

2.5 Assess if the bank has red flags related to correspondent banking operations.

2.6 Assess if the bank has procedures to detect unusual and suspicious transactions that are carried out within the correspondent banking relationship.

FRAMEWORK

1. Financial action task force (FATF)

1.1 Recommendation 13 “Correspondent Banking”

FATF Recommendation 13 requires financial institutions that in addition to performing normal customer due diligence measures, to:

- (a) Gather sufficient information about a respondent institution to understand fully the nature of the respondent’s business and to determine from publicly available information the reputation of the institution and the quality of supervision, including whether it has been subject to a money laundering or terrorist financing investigation or regulatory action.
- (b) Assess the respondent institution’s AML/CFT controls.
- (c) Obtain approval from senior management before establishing new correspondent relationships.
- (d) Clearly understand the respective responsibilities of each institution.
- (e) With respect to “payable-through accounts”, be satisfied that the respondent bank has conducted CDD on the customers having direct access to accounts of the correspondent bank, and that it is able to provide relevant CDD information upon request to the correspondent bank.

Financial institutions should be prohibited from entering into, or continuing, a correspondent banking relationship with shell banks. Financial institutions should be required to satisfy themselves that respondent institutions do not permit their accounts to be used by shell banks.

1.2 Guidance on Correspondent banking

The Guide on Correspondent banking of FATF propose the following:

- 1) Identify the risks
 - 1.1) Due diligence on the respondent institution.
 - 1.2) Developing an understanding of the respondent institution’s business
- 2) Verifying respondent institutions’ information, and assessing / documenting higher risks
- 3) Managing the risks
 - 3.1) Ongoing due diligence on the respondent institution
 - 3.2) Ongoing transaction monitoring
 - 3.3) Ongoing monitoring and request for information about transactions
 - 3.4) Clear terms governing the correspondent banking relationship
 - 3.5) Ongoing communication and dialogue
 - 3.6) Adjusting the mitigation measures to the evolution of risks

2. Bank for International Settlements (BIS)

2.1 Correspondent banking – Advisory Report

The Committee on Payments and Market Infrastructures presented the following five recommendations for correspondent banking:

- 1) *Use of “Know Your Customer” (KYC) utilities*

The use of KYC utilities by the correspondent and respondent banks could serve as an effective means of reducing the compliance burden on the due diligence requirements of the customer for the bank. In addition to standardizing the information, it would serve to reduce the costs associated with customer due diligence.

2) *Use of "Legal Entity Identifier" (LEI) utilities*

Consideration should be given to promoting the use of LEI utilities for all banks with correspondent banking operations as a means of identification that must be provided in KYC applications and information exchange agreements. In a cross-border context, this measure should ideally be coordinated and applied simultaneously in a large number of jurisdictions.

3) *Information Exchange initiatives*

It is recommended that the FATF and AMLEG be invited to: i) provide greater clarity on due diligence recommendations for correspondent banks, particularly to what extent banks need to know their clients' clients (KYCC) ; and ii) continue studying how to address the obstacles of information exchange in order to identify possible best practices (in the context of companies, between financial institutions that are not part of the same financial group and between the public sector and private sector).

4) *Payment message*

It is recommended that banks decide individually which payment method best meets their needs and those of their customers and agree with other banks involved in the method to be used. The Wolfsberg Group and the Payment Market Practice Group (PMPG) are invited to examine its principles governing the use cases of payment messages. The documents must include information on the data that the payment messages must contain, as well as the data fields that must be used to provide relevant information to carry out the due diligence of the client.

5) *Use of LEI as additional information in payment messages*

The use of the LEI as additional information in the payment messages should be optional in the payment messages. To allow optional use of the LEI, work should be done to define a common market practice on how to include the LEI in current payment messages without changing the structure of the current message.

3. Wolfsberg Group

3.1) Wolfsberg Principles

The Wolfsberg Principles for Money Laundering in Correspondent Banking define guidelines that institutions must follow to have a better understanding of the ML/FT prevention systems that their correspondents have and to be more certain about the operations that are channeled through of correspondent banking. Wolfsberg's principles are as follows:

1) *Responsibility and Oversight*

The institution will define policies and procedures that require the existence of persons responsible for ensuring compliance with these principles. Policies and procedures will require that at least one-person superior or independent of the officer supporting the relationship approve said correspondent banking relationship.

2) *Risk Based Due Diligence*

Correspondent banking clients that present greater risks should be subject to a higher level of due diligence. The institution should consider risk indicators, at the beginning of a correspondent relationship, such as the client's domicile, the client's property and its management structure, and the client's business and client base. Thus, all correspondent banking customers will be subject to appropriate due diligence to try to ensure that the institution feels safe doing business with a particular client in response to its risk profile.

3) *Enhanced Due Diligence*

In addition to due diligence, each institution must carry out due diligence to those correspondent banking clients that pose greater risks. The reinforced due diligence process should involve the additional consideration of the following elements to ensure a higher level of knowledge: participation of PEPs, customer laundering prevention controls and downstream correspondent clearing.

4) *Monitoring and Reporting of Suspicious Activities*

The institution shall implement bank-wide policies and procedures to detect and investigate unusual or suspicious activity and report any such activity as required by applicable law. These will include guidance on what is considered to be unusual or suspicious and give examples thereof. The policies and procedures shall include appropriate monitoring of the Correspondent Bank's activity.

5) *Integration with Anti-Money Laundering Program*

These Principles shall form an integral component of the institution's wider anti-money laundering program, including anti-bribery and corruption, fraud and evasion of sanctions.

PROCEDURES

1. Specific objectives 1: Assess the process of identifying the ML/FT risks associated with correspondent banking relationships

Objective	Procedures	Details
<p>1.1 Assess if the bank has established due diligence procedures for the banks with which it intends or has established correspondent banking relationships.</p>	<ol style="list-style-type: none"> 1. Assess the existence of due diligence procedures for correspondent relationships. 2. Assess if the established procedures are applied. 	<ol style="list-style-type: none"> 1. Request the list of correspondent banking relationships of local banks and extract a sample of files based on the risk level of the foreign bank according to the Methodology of Annex N° 2. 2. Assess that in all the files of the sample it is fulfilled that the due diligence procedures consider, at least, the following: <ul style="list-style-type: none"> - Jurisdiction of the correspondent or respondent bank - Make sure it is not a shell bank - Sanctions and / or investigations in progress on recent years - Bank ownership structure - Bank's ML/FT prevention system - Products or services that will be carried out in the correspondent banking relationship
<p>1.2 Assess if the bank has established procedures to know in depth the business of the bank with which it intends or has established correspondent banking relationships.</p>	<ol style="list-style-type: none"> 1. Assess the existence of procedures to know in depth the business of the correspondent or respondent bank. 2. Assess the application of the procedures established by the bank. 	<ol style="list-style-type: none"> 1. From the sample of files, evaluate that, before the correspondent agreement, the bank obtained sufficient information in order to understand the business of the correspondent or respondent. This information should consider, among other aspects, the following: <ul style="list-style-type: none"> - Existence of subsidiaries of the bank - Bank ownership and management structure - Products and services offered by the bank - The type of customers the bank is targeting - Areas where the banks offer their products
<p>Assess if the bank has established and implemented procedures for the</p>	<ol style="list-style-type: none"> 1. Assess if the bank has established questionnaires or 	<ol style="list-style-type: none"> 1. From the sample of files, analyze if the questionnaires applied by the bank to evaluate the ML/FT prevention system consider, at

<p>evaluation of the ML/FT prevention system of correspondent or respondent banks</p>	<p>other formats to evaluate the ML/FT prevention system, or that it conducts the evaluation directly with the supervisor of the jurisdiction to which the bank with which it wants to initiate correspondent banking relationships.</p> <p>2. Assess if the bank has implemented the established processes.</p>	<p>least, the following points:</p> <ul style="list-style-type: none"> - It has a Compliance Officer. - Number of people that compose the compliance department. - It has methodologies for customer rating and risk factors ML/FT. - It has automated red flags. - Make quarterly or biannual reports. <p>2. Assess if the bank issues an opinion regarding the quality of the management of the ML/FT prevention system of the bank evaluated.</p>
<p>1.4 Assess if the bank has policies to ensure that correspondent or respondent banks have a license issued by the competent authority in the jurisdictions in which they operate</p>	<p>1. Request information that certifies that correspondents or respondents banks have licenses in the jurisdictions where they operate.</p> <p>2. Assess if the verification of the license is part of the process prior to the correspondent agreement.</p>	<p>1. From the sample of files, evaluate that there is a copy of the operating license issued by the competent authority.</p>
<p>1.5 Assess if the correspondent banking agreements define the purpose of the correspondent relationship and the responsibilities for risk prevention and management of ML/FT of each participant.</p>	<p>1. Assess if the correspondent agreements establish the purpose of the contractual relationship and the responsibilities regarding ML/FT of each participant.</p>	<p>1. From the sample of files, evaluate that the correspondent agreements indicate the types of operations that will be carried out with the correspondent or respondent bank.</p> <p>2. Evaluate that the correspondent agreements clearly define the responsibilities regarding prevention of ML/FT of the correspondent or respondent, as the duty to share customer due diligence information.</p>
<p>1.6 Assess if the bank has implemented procedures that prohibit transactions with shell banks.</p>	<p>1. Assess if there are procedures that prohibit operations with shell banks.</p>	<p>1. Assess if the internal normative documents contemplate the prohibition of carrying out transactions with shell banks.</p>

<p>1.7 Assess if the bank has developed and implemented policies and procedures to identify and register in the enhanced due diligence the banks with which correspondent banking relationships are maintained.</p>	<ol style="list-style-type: none"> 1. Assess if that there are procedures to identify higher risk customers. 2. Assess if there are enhanced measures to apply to banks subject to it. 	<ol style="list-style-type: none"> 1. Assess if that the procedures consider, among others, the following aspects: <ul style="list-style-type: none"> - Participation of PEPs in the shareholding structure. - Insufficient AML/CFT controls. - Has been sanctioned or investigated - Use of nested accounts (Downstream correspondent clearing) 2. Request the list of applicable enhanced measures.
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2. Specific objective 2: Assess the management of ML/FT risks associated with correspondent banking relationships

Objective	Procedures	Details
<p>2.1 Assess if the bank verifies the minimum information necessary in electronic transfers, from correspondent banking, before making them.</p>	<ol style="list-style-type: none"> 1. Assess if the company has policies and procedures based on ML/FT risks to determine: i) when to execute, reject or suspend a transfer that lacks the minimum required information and ii) the appropriate follow-up action 	<ol style="list-style-type: none"> 1. Request the procedures that the bank use to determine when to execute, reject or suspend a transfer for ML/FT reasons. 2. Assess, on a sample files, the procedures are applied in an automated way. 3. Request the procedures that the bank has to track transfers when required, according to the conditions established. 4. Assess the application of the procedure for monitoring transactions and customers.
<p>2.2 Assess the procedures for the continuous monitoring of the transactions made in favor of the customers of respondent bank.</p>	<ol style="list-style-type: none"> 1. Assess if the bank includes the continuous monitoring of transactions. 2. Assess the procedure that is followed for the continuous monitoring of transactions. 3. Assess the systematization of the procedure and the red flags. 	<ol style="list-style-type: none"> 1. Request the procedures and requirements for continuous monitoring of transactions. 2. Review the basis of the transactions and identify those that require continuous monitoring and assess if, in effect, they are monitored.

<p>2.3 Assess if the bank applies enhanced measures to correspondent or respondent banks subject to the enhanced due diligence</p>	<ol style="list-style-type: none"> 1. Request the list of correspondent banks or respondents subject to enhanced due diligence and the reasons why. 2. Request a sample of bank records under an EDD and determine if enhanced measures are applied. 	<ol style="list-style-type: none"> 1. Request the list of banks with which correspondent banking relationships are maintained and the list of banks in an EDD. 2. Cross the list of banks with the database of internationally investigated or sanctioned banks (Annex N° 4) and assess if all the investigated or sanctioned banks have been identified and registered under an EDD. 3. From the list of banks in an EDD, request the files and assess the internally established enhanced measures are applied.
<p>2.4 Assess if the bank has procedures for the de-risking of correspondent or respondent banks for reasons related to ML/FT</p>	<ol style="list-style-type: none"> 1. Request the procedure for the de-risking of correspondent or respondent banks for ML/FT reasons. 2. Request the due diligence files of the unlinked banks for ML/FT reasons. 	<ol style="list-style-type: none"> 1. Assess if the bank has procedures for unbinding correspondents or respondents, in which the reasons for terminating the correspondent relationship are indicated. 2. If this is the case, assess that the bank has the support that justifies the termination of the correspondent relationship.
<p>2.5 Assess if the bank has red flags related to correspondent banking operations.</p>	<ol style="list-style-type: none"> 1. Assess if the established red flags are consistent with the characteristics and nature of the operations performed by the customers of the respondent bank. 2. Assess the methodology for evaluations of the red flags. 	<ol style="list-style-type: none"> 1. Request the list of red flags implemented in the entity's ML/FT monitoring system (automated or manual). 2. Request the established criteria and procedures to activate the red flags and assess whether they are consistent at the transactional level. 3. Request the list of red flags that have been activated (monthly) during the exercise prior to the evaluation and assess which ones have been analyzed and which are still open.

<p>2.6 Assess if the bank has procedures to detect unusual and suspicious transactions that are carried out within the correspondent banking relationship.</p>	<ol style="list-style-type: none"> 1. Assess if the bank has implemented internal procedures for consultation and communication of unusual operations. 2. Assess the procedures associated with the analysis of unusual operations. 	<ol style="list-style-type: none"> 1. Request the document in which the procedures to analysis unusual operations and SAR are established. 2. Request a list of unusual operations detected that have not been reported as suspicious. 3. Select a sample of unusual operations and request the respective file, and assess if they include the reason why you were not qualified as a suspect.
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ANNEX N° 2: ML/FT RISK ASSESSMENT METHODOLOGY FOR CORRESPONDENT BANKING RELATIONSHIPS

1. OBJECTIVE

To establish guidelines to determine the level of ML/TF risks of supervised banks due to their correspondent banking relationships with foreign banks.

2. SCOPE

This methodology for assessing ML/TF risks is applicable to local banks that have correspondent banking agreements with foreign banks, whether the local bank acts as a correspondent or as respondent.

3. DEFINITIONS

- Correspondent Bank: It is the bank that provides financial services to a local bank, so that the customers of the respondent bank can execute different operations.
- Respondent Bank: It is the bank to which the correspondent bank provides financial services to carry out operations on behalf of its own customers.
- FATF: Financial Action Task Force.
- ML/FT: Money Laundering and Financing of Terrorism

4. ML/FT RISK ASSESSMENT METHODOLOGY FOR CORRESPONDENT BANKING RELATIONSHIPS

The ML/FT risk assessment methodology for correspondent banking relationships is based on the evaluation of two components. The first measures the bank's exposure to ML/FT risks by the number of correspondent banking agreements and the volume of transactions channeled through these relationships. On the other hand, the second measures the quality of the bank's ML/FT risk management through the results of the On-site / Off-site assessment, the identification of banks subject to enhanced due diligence and the use of the accounts in correspondent banking relationships.

4.1. LOCAL BANK'S ML/FT RISK EXPOSURE

The first stage of the ML/FT risk assessment methodology for correspondent banking relationships starts with the measurement of the level of exposure to ML/TF risks of the local bank. To do this, the methodology divides the evaluation into two steps. The first focuses on the exposure of the foreign bank to ML/TF risks, for which it evaluates four variables: inclusion in the FATF list, tax haven condition, Basel's AML Index rating and Financial Secrecy Index rating. The second one focuses on the ML/FT risk management by the foreign bank based on three variables: inclusion in UN or OFAC lists, sanctions or investigations regarding ML/TF matters and risk of belonging to an economic group.

4.1.1. FOREIGN BANK'S RISK LEVEL

4.1.1.1. FOREIGN BANK'S ML/FT RISK EXPOSURE

4.1.1.1.1. V₁: FATF listing

Description	The jurisdiction is listed as non-cooperative by the FATF										
Definition	<table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th>Condition</th> <th>Score</th> </tr> </thead> <tbody> <tr> <td>Black list</td> <td>10</td> </tr> <tr> <td>Gray list</td> <td>8</td> </tr> <tr> <td>Intensified monitoring</td> <td>6</td> </tr> <tr> <td>Not listed</td> <td>1</td> </tr> </tbody> </table> <p>Those cases in which the foreign bank operates in a jurisdiction over which the FATF has appealed is considered a higher level of risk. The FATF makes a distinction of three lists to indicate the level of deficiencies in the ML/TF prevention systems of these jurisdictions.</p>	Condition	Score	Black list	10	Gray list	8	Intensified monitoring	6	Not listed	1
Condition	Score										
Black list	10										
Gray list	8										
Intensified monitoring	6										
Not listed	1										
Fundament	If the jurisdiction is listed, it is understood that the FATF shows concern regarding the effectiveness of the ML/TF prevention systems developed by the jurisdictions, which means a higher level of risk for the foreign bank.										
Periodicity	The evaluation is carried out semiannually										

4.1.1.1.2. V₂: Tax haven Condition

Description	The jurisdiction is considered to be a tax haven						
Definition	<table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th>Condition</th> <th>Score</th> </tr> </thead> <tbody> <tr> <td>Tax haven</td> <td>10</td> </tr> <tr> <td>Not considered to be a tax haven</td> <td>1</td> </tr> </tbody> </table> <p>Those cases in which the foreign bank operates in a jurisdiction considered to have low or zero taxation according to the local tax authority, or other international body, are considered to have higher level of risk.</p>	Condition	Score	Tax haven	10	Not considered to be a tax haven	1
Condition	Score						
Tax haven	10						
Not considered to be a tax haven	1						
Fundament	The condition of tax haven increases the risk of criminal activities such as tax evasion, to be carried out in said jurisdiction. Regulations regarding the transparency of financial systems usually are laxer than in other jurisdictions						
Periodicity	The evaluation is carried out semiannually						

4.1.1.1.3. V₃: Basel's AML Index rating

Description	AML/CFT rating given by the Basel Institute of Governance						
Definition	<table border="1" data-bbox="643 327 1121 454"> <thead> <tr> <th>Condition</th> <th>Score</th> </tr> </thead> <tbody> <tr> <td>Has been rated</td> <td>Rating</td> </tr> <tr> <td>Has not been rated</td> <td>5</td> </tr> </tbody> </table> <p>The Basel Institute of Governance has rated 149 jurisdictions in its latest edition of the AML Index, giving them a maximum score of 10, being the highest rating for ML/FT risks. In those cases in which a jurisdiction has not been rated, a rating of 5 (medium risk) is granted.</p>	Condition	Score	Has been rated	Rating	Has not been rated	5
Condition	Score						
Has been rated	Rating						
Has not been rated	5						
Fundament	Basel's AML rating takes into account variables such as: deficiencies in ML/FT prevention systems, lack of transparency in financial systems, levels of corruption, among others. Thus, those jurisdictions rated with a high score are considered to have a higher level of ML/FT risks.						
Periodicity	The evaluation is carried out annually						

4.1.1.1.4. V₄: Financial Secrecy Index rating

Description	Financial transparency rated by the Tax Justice Network (TJN)						
Definition	<table border="1" data-bbox="643 1095 1121 1223"> <thead> <tr> <th>Condition</th> <th>Score</th> </tr> </thead> <tbody> <tr> <td>Has been rated</td> <td>Rating/10</td> </tr> <tr> <td>Has not been rated</td> <td>5</td> </tr> </tbody> </table> <p>The Tax Justice Network has rated 102 jurisdictions in its latest edition of the Financial Secrecy Index, granting them a maximum score of 100, being the highest rating for ML/FT risks. This index has a greater weight on transparency regarding final beneficiaries and strength of bank secrecy in the jurisdictions evaluated. In those cases in which a jurisdiction has not been rated, a rating of 5 (medium risk) is granted.</p>	Condition	Score	Has been rated	Rating/10	Has not been rated	5
Condition	Score						
Has been rated	Rating/10						
Has not been rated	5						
Fundament	The Financial Secrecy Index rating takes into account variables such as: bank secrecy, trust and foundations registry, ML/FT prevention systems, information exchange agreements. Thus, those jurisdictions rated with a high score are considered to have a higher level of ML/FT risks.						
Periodicity	The evaluation is carried out annually						

4.1.1.2. FOREIGN BANK'S ML/FT RISK MANAGEMENT

4.1.1.2.1. V₅: Sanctions and investigations

Description	Sanctions or investigations relating to AML/CFT deficiencies								
Definition	<table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th>Condition</th> <th>Score</th> </tr> </thead> <tbody> <tr> <td>Sanctioned</td> <td>10</td> </tr> <tr> <td>Investigated</td> <td>6</td> </tr> <tr> <td>Neither sanctioned nor investigated</td> <td>1</td> </tr> </tbody> </table> <p>Those cases in which the foreign bank has been sanctioned by the competent authority in its jurisdiction as a result of deficiencies in the ML/FT prevention system, the bank is considered to have a higher level of risk. If the bank is under investigation, or has been previously investigated, for deficiencies in its ML/FT prevention systems, it is considered a medium level of risk.</p> <p>This variable should include sanctions or investigations imposed even after the date the bank has remitted information regarding its correspondent banking relationships (Annex N° 3), considering that the local bank was exposed to a bank with deficiencies in its prevention systems.</p> <p>For the rating of this variable, public access information from the last 5 years is used.</p>	Condition	Score	Sanctioned	10	Investigated	6	Neither sanctioned nor investigated	1
Condition	Score								
Sanctioned	10								
Investigated	6								
Neither sanctioned nor investigated	1								
Fundament	If the foreign bank has been sanctioned, or is under investigation, it is considered at greater risk due to deficiencies in the bank's ML/FT prevention systems.								
Periodicity	The evaluation is carried out semiannually								

4.1.1.2.2. V₆: Economic Group Risk

Description	Risks derived from banks belonging to the same economic group
Definition	$V_{6j} = \frac{\sum_{i=1}^n \frac{V_{1ij} \times W_1 + \dots + V_{5ij} \times W_5}{(W_1 + \dots + W_5)}}{n_j}$ <p>V₁: Variable 1's score W₁: Variable 1's weight n: Number of banks of the same economic group i: Bank belonging to economic group j j: Economic Group</p> <p>This variable measures the level of risk of the foreign bank by belonging to an economic group made up of other banks that perform correspondent banking operations.</p> <p>This variable is calculated as the average score of the variables from 1 to 5 of all the banks that make up the same group. In that sense, Variable 6 of a bank is the same as for the rest of the banks that make up the same economic group.</p>
Fundament	Foreign banks are considered to be at greater risk of ML/FT when other banks in their same economic group are at a high level of ML/FT risk, due to the operations they can

	carry out with them and that they share policies at a group level. In that sense, the risk exposure variables and the risk management variables are taken into account.
Periodicity	The evaluation is carried out semiannually

4.1.1.2.3. V₇: UN or OFAC listing

Description	The bank is included in the list made by the UN or OFAC
Definition	In cases where the foreign bank is included in any of the lists of the United States Office of Foreign Assets Control (OFAC) or the United Nations Security Council, the level of risk of the bank shall be deemed to be automatically "High", without taking into account the other variables. This variable does not have a weight compared to the others. Only in the event that there is a match there shall be an override to the general rating, automatically giving a score of 10 (High) to the foreign bank.
Fundament	If the bank is listed, it is understood that the agency has made a special appeal with respect to the foreign bank, considering it to be at greater ML/FT risk.
Periodicity	The evaluation is carried out semiannually

4.1.1.3. FOREIGN BANK'S ML/FT RISK LEVEL

The following weights have been assigned for the variables described in the sections 4.1.1.1 and 4.1.1.2.

		Absolute Weight	
Foreign bank's ML/FT risk exposure		46%	
1.1	FATF listing	20%	W ₁
1.2	Tax haven condition	9%	W ₂
1.3	Basel's AML Index rating	9%	W ₃
1.4	Financial Secrecy Index rating	8%	W ₄
Foreign bank's ML/FT risk management		54%	
2.1	Sanctions or investigations	30%	W ₅
2.2	Economic risk group	24%	W ₆
2.3	UN or OFAC listing		

From the application of the score of each variable and their respective weights, a final grade is obtained for each foreign bank, according to the following formula:

$$RL_i = V_1 * W_1 + V_2 * W_2 + (...) + V_6 * W_6$$

Where:

RL_i : ML/FT risk level of foreign bank "i"

V_1 : Variable 1's score

W_1 : Variable 1's weight

According to the score obtained, the bank is rated with a high, medium or low level of risk, according to the following interval:

Rating	Risk Level
$RL_i < 4$	Low (LL)
$4 \leq RL_i < 6$	Medium (ML)
$6 \leq RL_i$	High (HL)

If a match is found with the UN or OFAC list, the bank is assigned with a score of 10 and is classified as a high risk level, without taking into account the other variables.

4.1.2. LOCAL BANK'S ML/FT RISK EXPOSURE MEASUREMENT

Based on the assessment of the level of ML/FT risks of the foreign bank, having been rated high, medium or low, the exposure to ML/FT risks of the local banks can be assessed. To do this, the relative importance of these correspondent relations with respect to the total correspondent relations is measured. In this way, two exposure criteria have been defined: by the Volume of Transactions and by the Number of Correspondent Banking Relationships.

4.1.2.1. EXPOSURE BY CORRESPONDENT BANKING TRANSACTIONS VOLUME

The local bank is considered to have a high level of exposure when 30% or more of its correspondent transactions are made with high-risk foreign banks; If 70% of the correspondent transactions are made with low risk correspondents, then the exposure level is also low; in case none of the two conditions is met, the exposure level is medium.

Conditions	Risk Level
<i>Low risk banks transaction volume (%) > 70%</i>	Low
<i>High risk banks transaction volume (%) ≥ 30%</i>	High
<i>Any other condition</i>	Medium

4.1.2.2. EXPOSURE BY NUMBER OF CORRESPONDENT BANKING RELATIONSHIPS

The local bank is considered to have a high level of exposure to ML/FT risks when 30% or more of its correspondent relationships are established with high-risk foreign banks; If 70% of the correspondent relationships are established with low-risk correspondents, then the exposure level is also low; In case neither of the two conditions is met, the exposure level is medium.

Conditions	Risk Level
<i># of Low risk banks (%) > 70%</i>	Low
<i># of High risk banks (%) ≥ 30%</i>	High
<i>Any other condition</i>	Medium

4.1.2.3. LOCAL BANK'S TOTAL RISK EXPOSURE

To determine the Total ML/FT Risk Exposure Level by correspondent banking relationships, the ratings obtained from the exposures by correspondent banking transaction volumes (4.1.2.1) and number of relationships (4.1.2.2) are added. The local bank is considered to have a high level of exposure, if one of both variables is high risk and the other is medium or high risk. It is only considered low risk when both variables are low risk. In any other case, there is a medium exposure.

Exposure:	By transaction volume			
	Risk:	Low	Medium	High
By number of relationships	High			
	Medium			
	Low			

4.2. LOCAL BANK'S ML/FT RISK MANAGEMENT

The second stage of the ML/FT risks assessment for correspondent banking relationships considers the ML/FT risk management of the local bank. For this, the methodology makes use of the following three variables: results of the On-site / Off-site assessment, identification of banks subject to enhanced due diligence and the use of accounts in the correspondent banking relationships.

4.2.1. ML/FT RISK MANAGEMENT VARIABLES

4.2.1.1. MV₁: ON-SITE / OFF-SITE ASSESSMENT RESULTS

Based on the evaluation of the two objectives indicated in the Guide for the Supervision of the Prevention and Management of ML/FT Risk System in Correspondent Banking (Annex N ° 2), a rating must be granted according to the degree of compliance of the bank local.

If there hasn't been recent On-site assessment, as far as possible, the policies and procedures contained in internal normative documents should be evaluated on the off-site, avoiding evaluations on the effectiveness of these policies and procedures that can only be verified in an On-site supervision.

The ratings are as follows:

- Satisfactory (S): The bank fully meets the evaluation criteria. To this end, depending on the criteria evaluated, it should be considered that the regulatory measures or requirements are fully developed in the internal regulations of the bank, as well as the development and implementation of associated procedures and the allocation of resources to carry out the activities.
- Adequate (A): The bank complies almost entirely with the criteria evaluated. Depending on the criteria evaluated, the regulatory measures or requirements should be considered to be in the final stage of development and implementation. If the criteria evaluated are implemented and there are only minor deficiencies to not consider the criterion as Satisfactory.
- Insufficient (I): The bank partially meets the criteria evaluated. In this way, the normative measures or requirements and their associated procedures or destined resources are in the process of elaboration, implementation or assignment.
- Deficient (D): The vast majority of procedures or measures, based on compliance with applicable standards, have not been developed or implemented.

These ratings have the following scores:

Rating	Score
Satisfactory	4
Adequate	3
Insufficient	2
Deficient	1

4.2.1.2. MV₂: IDENTIFICATION OF BANKS SUBJECT TO ENHANCED DUE DILIGENCE

From the information provided by the banks, it should be verified, in contrast to the base of banks that have been sanctioned or investigated in the last 5 years (Annex N ° 4), that foreign banks have been correctly identified as subject to enhanced due diligence. In this way, a proportion of unidentified banks is calculated over the total of sanctioned or investigated banks with which the local bank maintains correspondent banking relationships; after that a score will be assigned on this variable according to the following:

Conditions		Score
<i># of sanctioned or investigated banks subject to EDD (identified)</i> <hr/> <i>Total # of sanctioned or investigated banks</i>	[95% , 100%]	4
	[85% , 95%[3
	[70% , 85%[2
	< 70%	1

This variable does not take into account other causes that may be justification for applying an enhanced due diligence to the foreign bank, since such causes could only be identifiable by the local bank and not by the supervisor; while information on sanctions and investigations can be mostly verified in public sources.

In the case in which the number of investigated or sanctioned banks that is subject to enhanced due diligence and the total number of investigated or sanctioned banks is zero, a score of 4 will be assigned.

4.2.1.3. MV₃: USE OF ACCOUNTS IN THE CORRESPONDENT BANKING RELATIONSHIPS

From the information provided by local banks, for each correspondent relationship with a foreign bank, the scores will be assigned according to the following:

Conditions		Score
The foreign bank has an account in the local bank	The local bank has an account in the foreign bank	
No	No	4
No	Yes	3
Yes	No	2
Yes	Yes	1

It should be noted that there is a correspondent relationship even when the agreement does not imply the holding of an account, as the banks could carry out active operations such as loans and letters of credit.

Then, an average of the scores is obtained for each correspondent banking relationship that the local bank has, according to the following:

$$MV_{3j} = \frac{\sum_{i=1}^n MV_{3ij}}{n_j}$$

MV₃: Management Variable 3

n: Number of correspondent banking relationships of the local bank

i: Foreign bank with a correspondent banking relationship with local bank j

j: Local bank

4.2.2. ML/FT RISK MANAGEMENT ASSESSMENT

The following weights have been assigned for the variables described in the sections 4.2.1.1, 4.2.1.2 and 4.2.1.3.

		Absolute Weight	
Local Banks' ML/FT Risk Management		100%	
1.1	On-Site/Off-Site Assessment Results	60%	MW ₁
1.2	Identification of banks subject to enhanced due diligence	25%	MW ₂
1.3	Use of accounts in the correspondent banking relationships	15%	MW ₃

From the application of the score of each variable and their respective weights, a final score is obtained for each local bank, according to the following formula:

$$MQ_i = MV_1 * MW_1 + MV_2 * MW_2 + MV_3 * MW_3$$

Where:

MQ_i : ML/FT Management Quality of local bank "i"

MV_1 : Management Variable 1's score

MW_1 : Management Variables 1's weight

According to the score obtained, the management of the local bank is rated according to the following intervals:

Score	Management Quality
$3.25 < MQ_i \leq 4$	Satisfactory
$2.5 < MQ_i \leq 3.25$	Adequate
$1.75 < MQ_i \leq 2.5$	Insufficient
$MQ_i \leq 1.75$	Deficient

4.3. LOCAL BANK'S ML/FT RISK LEVEL

To determine the ML/FT Risk Level of the Local Bank, the ratings obtained from the Local Bank's ML/FT Risk Exposure (4.1) and Local Bank's ML/FT Risk Management (4.2) are added. The local bank is considered to have a high level of risk when the exposure level is high and the quality of management is different from Satisfactory. It is only considered low risk when the level of exposure is low or medium and the quality of management is Satisfactory, and when the quality of management is Adequate and the level of exposure is low. In any other case, it is considered a medium level of risk.

Management Quality	Exposure Level		
	Low	Medium	High
Deficient	Yellow	Red	Red
Insufficient	Yellow	Yellow	Red
Adequate	Green	Yellow	Red
Satisfactory	Green	Green	Yellow

METHODOLOGY'S ANNEX

EXPOSURE VARIABLES WEIGHT ESTIMATE

The Analytic Hierarchy Process (AHP) is a technique for decision making, by establishing weights of factors considering the relationship between them. The process of establishing weights of this technique is used to establish the weights of the ML/FT exposure and risk management variables used to measure the Total Risk Level of the Foreign Bank.

The following variables have been defined:

V	Variable
V1	FATF listing
V2	Tax haven condition
V3	Basel's AML Index
V4	Financial Secrecy Index
V5	Sanctioned or investigated condition
V6	Economic Group Risk

Intensities of relative importance are assigned:

		1	2	3	4	5	6
V1	1	1.00	2.00	2.00	4.00	0.50	1.00
V2	2	0.50	1.00	1.00	1.00	0.25	0.50
V3	3	0.50	1.00	1.00	1.00	0.25	0.50
V4	4	0.25	1.00	1.00	1.00	0.25	0.50
V5	5	2.00	4.00	4.00	4.00	1.00	0.50
V6	6	1.00	2.00	2.00	2.00	2.00	1.00

According to the relative importance, the following weights are reached:

V	Weight
V1	20.49%
V2	8.96%
V3	8.96%
V4	8.17%
V5	29.60%
V6	23.81%

A **Consistency Ratio of 0.0452** has been obtained.

ANNEX N° 3: FORMAT FOR THE RELEASE OF CORRESPONDENT BANK INFORMATION

Indications:

A correspondent banking relationship is considered to exist when the correspondent bank provides a service in favor of a client of the responding bank. In this format, the operations in which the local bank acts as a respondent, as well as when it acts as a correspondent of a foreign bank must be registered. The information entered must be with respect to those operations of the clients, but not those that the bank performs on its own.

About filling:

- (1) Indicate the SWIFT Code of the Correspondent Bank. Only the first 8 digits, without blanks or hyphens.
- (2) Indicate the name of the correspondent or respondent bank.
- (3) Indicate the jurisdiction where the operating license was obtained.
- (4) To complete "volume of transactions", consider the total dollar amounts (units) of transactions, both sending and receiving.
- (5) To complete "Does the foreign bank have an account at the local bank?" Indicate "Yes" or "No".
- (6) To complete "Does the local bank have an account at the foreign bank?" Indicate "Yes" or "No".
- (7) To complete "Is the bank in EDD?" Indicate "Yes" or "No".
- (8) Indicate the reason of the inclusion in EDD, if not applicable, leave blank.

(1) SWIFT Code	(2) Banks' names	(3) Jurisdiction	(4) Volume of transactions (US\$)						(5) Does the foreign bank have an account at the local bank?	(6) Does the local bank have an account at the foreign bank?	(7) Is the bank in EDD?	(8) Reason of the inclusion in EDD
			Month 1	Month 2	Month 3	Month 4	Month 5	Month 6				

ANNEX N° 4: TEMPLATE FOR THE DATABASE OF FOREIGN BANKS

Based on the information sent by the banks, through the Annex N° 3, it is recommended to the supervisor to prepare a database of all the foreign banks with which the local banks have, or have maintained, correspondent banking relationships. Since the Methodology contemplates a single level of ML/FT risks for each foreign bank, and it depends solely on its characteristics, having the following information about foreign banks from different banks means knowing the foreign banks better.

First, the SWIFT code or equivalent must be consigned, considering that other messaging systems can be used, which corresponds to a single bank. It should be inquired if this bank belongs to an economic group, in which case, it must be indicated in the second column, ensuring that all members of the group are registered with the same name. After that, the commercial name of the bank and its jurisdiction must be indicated. It should be taken into account that more than one bank may have the same name.

Finally, the supervisor must inquire if the foreign bank has been sanctioned or investigated for deficiencies in its ML/FT prevention systems. According to what is established in the Methodology, said information must be obtained by public sources. This is because of the necessary evaluation of the ability of the local bank to identify those cases which require the application of an enhanced due diligence of a foreign bank. The year of the sanction or investigation must also be recorded, considering the 5-year term established by the Methodology. Additionally, the information about sanctions and investigations must be updated at least once a year.

SWIFT code	Economic Group	Foreign banks' name	Jurisdiction	Investigations	Sanctions	Year	Source