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Correspondent Banking: A Gateway to Money Laundering Requires Heightened Scrutiny

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Fifteen years ago, the Senate Permanent Subcommittee on Investigations flagged correspondent banking as a "Gateway for Money Laundering."[1] The voluminous report highlighted a number of deficiencies with banks maintaining their correspondent banking relationships. Such deficiencies presented a significant money laundering risk to the U.S. financial system. Now, enforcement actions highlighting these deficiencies continue. Recent reports continue to flag the money laundering risks associated with correspondent banking.[2] In this era of heightened scrutiny with compliance with Bank Secrecy Act (BSA) and Anti-Money Laundering (AML) controls, continued review and updating of compliance protocols is imperative to mitigate enforcement risks to financial institutions.

Understanding Correspondent Banking

Correspondent banking refers to the provision of banking services by one bank to another bank, and can involve a U.S. domestic financial institution providing banking services to a foreign financial institution and its customers in a foreign country. The domestic U.S. bank is the correspondent bank. The foreign bank is referred to as the respondent bank.

Such a relationship allows the foreign bank to gain access to the U.S. financial system and move funds, exchange currencies, or provide other financial transactions to the foreign bank's customers. The foreign bank is also able to access a variety of "services and products that may not be available in the foreign financial institution's jurisdiction."[3] These services facilitate international trade and include, but are not limited to, cash management services, international funds transfers, and check clearing. A primary benefit provided by correspondent banking relationships is access to the international wire system which, in turn, allows for the rapid transfer of funds between domestic and foreign jurisdictions.

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Recent cases have addressed correspondent banking, finding that "[c]orrespondent accounts facilitate the flow of money worldwide, often for transactions that otherwise have no other connection to … the United States."[4] Jurisdiction over foreign nationals with limited contacts with the United States has been found through correspondent banking.[5]

Certain financial institutions that manage private banking or correspondent accounts in the United States for non-U.S. persons are required to establish risk-based due diligence policies, and, in some cases, enhanced due diligence policies, procedures, and controls that are designed to detect and report suspicious activity indicative of money laundering.[6] Due diligence programs must assess the money laundering risks presented by the correspondent account by considering all relevant factors, including, as appropriate, the: (1) nature of the foreign financial institution's business and the markets it serves; (2) type, purpose, and anticipated activity of the account; (3) nature and duration of the bank's relationship with the foreign financial institution and its affiliates; (4) AML and supervisory regime of the jurisdiction issuing the license for the foreign financial institution; and (5) information known or reasonably available about the foreign financial institution's AML record.[7]

Practically speaking, this relationship exposes the correspondent bank to money laundering risks because the correspondent bank must rely on the foreign bank's AML protocols to identify the foreign bank's customer, including beneficial owners, conduct due diligence, and otherwise monitor account activity. Further, the risks multiply when dealing with nested correspondent accounts, where the respondent bank provides access to third-party foreign financial institutions, which then allows other foreign financial institutions to gain access to the U.S. financial system through an existing correspondent relationship. Enhanced due diligence is required where a foreign bank for which a correspondent account is established in turn maintains correspondent accounts for other foreign banks.[8]

Key Reports on Correspondent Banking

Numerous reports issued by the U.S. government and respected non-governmental associations have addressed the risks associated with correspondent banking. As noted above in the Senate Report, the Senate Permanent Subcommittee on Investigations highlighted such risks seven months before the 9/11 terrorist attacks. The report declared that correspondent banking rendered U.S. banks "conduits for dirty money flowing into the American financial system," thereby facilitating the functioning of unlawful activities, including drug trafficking and financial fraud.[9]

Among the risks tied to correspondent banking, the Senate Report underscored hazards associated with nesting: the Senate investigation uncovered numerous instances of foreign banks gaining access to U.S. banks by "nesting." This occurs when a foreign bank opens an account at another foreign bank which, in turn, has a correspondent account at a U.S. bank, effectively allowing the foreign bank to make use of a correspondent account without directly opening an account itself.[10]

Recent reports issued by non-governmental associations and trade groups have focused on best practices in this area. In February 2016, The Clearing House Association, a trade group including some of the largest U.S. banks, published an updated version of its guiding principles to provide guidance to U.S. banks engaged in correspondent banking.[11] Acknowledging that correspondent banking "fosters economic prosperity throughout the world," it also recognized that "industry standards have progressed to reflect the industry's enhanced understanding of the money laundering risks associated with correspondent accounts and to meet the evolving regulatory requirements and expectations."[12] The Guiding Principles discuss many areas of concern, including prohibited relationships with correspondent accounts, preventing unwanted use of correspondent services, transparency in funds transfers, and sanctions risks.[13]

Recent Enforcement Actions

In recent years, financial regulators and prosecutors have brought more actions against banks in part because of the "increased scrutiny and elevated expectations."[14]

In March 2015, Commerzbank AG entered into agreements with the U.S. Department of Justice, the Federal Reserve Bank, and the New York State Department of Financial Services (DFS) in connection with multiple regulatory failures, including failure to establish due diligence for foreign correspondent accounts.[15] More specifically, prosecutors and regulators faulted the bank for inadequately conducting due diligence on transactions of Commerzbank's foreign branches and affiliates flowing through Commerzbank's U.S. accounts in New York.[16]

The actions against Commerzbank were precipitated in part by the revelation of a multi-year accounting fraud at Japanese-based publicly-traded

manufacturer of medical devices.[17] The massive accounting fraud, which came to light in 2011, was perpetrated to conceal hundreds of millions of dollars in losses and resulted in guilty pleas of three of the company's senior executives.[18] Multiple transactions which facilitated the fraud scheme flowed through Commerzbank's New York-based correspondent accounts for Commerzbank's Singapore branch.[19] While prosecutors acknowledged that the BSA generally does not require banks to conduct due diligence on a foreign bank's customer's customers, they faulted Commerzbank for failing to detect and report suspicious activity, which might have been accomplished through additional due diligence and enhanced due diligence by Commerzbank New York.[20]

On June 30, 2015, the Cooperative Centrale Raiffeisen-Boerenleenbank BA (Rabobank) and its New York branch entered into an agreement with the Federal Reserve Bank of New York and the DFS requiring Rabobank to (1) submit a written plan to strengthen oversight of BSA/AML compliance; (2) retain an independent third party to conduct a comprehensive review of the New York branch's compliance with BSA/AML requirements; (3) create an enhanced BSA/AML compliance program for the New York branch; (4) submit an enhanced customer due diligence program; and (5) submit a written program to ensure identification and timely reporting of suspicious transactions to law enforcement.[21] This agreement with regulators followed the identification of deficiencies in Rabobank's BSA/AML compliance program and its reporting of suspicious activity. Significantly, the bank was to place particular emphasis on due diligence with respect to foreign correspondent accounts maintained at the New York branch.

On Oct. 15, 2015, Credit Agricole S.A. and its New York branch entered into a Consent Order with the DFS, agreeing to (1) a monetary payment of $385 million; (2) the termination of a specific bank employee employed in France; and (3) hire an independent consultant for one year to conduct a comprehensive review of the bank's existing BSA/AML and sanctions compliance programs.[22]

The Consent Order provided that the bank had policies and procedures approved by the highest level of its legal and compliance staff, who directed the bank to intentionally omit the identifying details from payment messages in wire transfers to hide the involvement in transactions of entities from countries subject to U.S. economic sanctions, including entities that appeared on the List of Specially Designated Nationals and Blocked Persons of the U.S. Treasury Department's Office of Foreign Assets Control (OFAC). According to the Consent Order, by processing these non-transparent payments for prohibited entities, the bank and its subsidiaries in Geneva rendered the New York branch's compliance function ineffective, failed to maintain adequate records, and weakened controls at the New York branch and at other correspondent banks to prevent review by regulators and other U.S. authorities. According to the Consent Order, non-transparent methods were used to process more than $32 billion in U.S. dollar payments on behalf of prohibited entities between August 2003 and 2008. The transactions at issue lacked information for Credit Agricole's New York Branch, as well as other financial institutions to identify the source or even the destination of the funds.

Mitigating Risks[23]

In light of the view that correspondent banking is a "gateway" to money laundering, and recognizing that increased scrutiny can result in enforcement actions that can be costly in terms of penalties (both civil and criminal), monitors, and reputation, compliance programs should be reviewed and updated to ensure best practices. Categories to consider include, for example:

• ***Account Opening Due Diligence.*** Prior to the creation of a correspondent account for a foreign bank, the U.S. bank should conduct due diligence or, depending on the risk assessment of the foreign bank, enhanced due diligence. Due diligence efforts may include a review of the following with regard to the foreign bank: licenses, recent annual reports, key senior management, AML and sanctions compliance programs, primary lines of business, local market reputation, references, categories of customers, and intended use and expected activity of the correspondent accounts.

• ***Assessment of Levels of Risks.*** Assess levels of risks associated with foreign banking relationships by considering high-risk jurisdictions known for crime, corruption, drug trafficking, or terrorist activity. In addition to a geographic risk assessment, identify and appropriately risk-rate all business lines, activities, and products. Risk assessment depends upon, in part, understanding the nature of the foreign bank's customers' businesses; the activity within the correspondent account; the purpose and legitimacy of nested correspondent banking relationships; and news relating to the foreign bank.

• ***Ongoing Monitoring.*** Monitor the activity in the correspondent account,

including payment messages related to transactions of the foreign bank's customer, to identify, investigate, and, if necessary, report suspicious activity. Ideally, actual activity should be compared with the account opening information to better enable the correspondent bank to file a suspicious activity report.

• ***Increased Transparency in Payment Processing.*** Correspondent banks should ensure that wire transfers include originator and beneficiary information, and ensure preservation of this information throughout the payment chain. Similarly, banks should also monitor wire transfers to ensure compliance with OFAC regulations and to block persons or entities subject to the OFAC sanctions program.

• ***Application of Due Diligence Requirements to Foreign Branches of Parent Bank.*** As underscored by the regulatory actions imposed upon Commerzbank, there is no exception to due diligence requirements for correspondent accounts held by foreign financial institutions within the same parent company.

• ***Updated Compliance Programs to Address Changing Regulatory Landscape.*** Correspondent banks should conduct assessments of internal compliance programs, policies, and procedures, and incorporate, if warranted, recent and pending rules affecting beneficial ownership disclosure requirements. In May 2016, for example, the Financial Crimes Enforcement Network of the U.S. Department of Treasury finalized a rule which will require banks and other financial institutions to collect information on the beneficial owners or "real persons" behind a legal entity at the time of account opening.[24] Likewise, pending federal legislation would require states to collect beneficial ownership information from limited liability companies and other corporate structures.[25]

In sum, correspondent banking continues to be a risk area for banks. Without proper controls, banks may unwittingly allow money laundering, terrorist financing, and other illicit schemes to be funded, as well as provide persons subject to U.S. sanctions with indirect access to the U.S. financial system. Implementation of these best practices is a crucial step towards minimizing exposure.

1. Senate Committee Print, 107th Congress: Correspondent Banking: A Gateway for Money Laundering (2001) (Senate Report).

2. See, e.g., Dep't of the Treasury, National Money Laundering Risk Assessment (2015).

3. Federal Financial Institutions Examination Council (FFIEC), Bank Secrecy Act/Anti-Money Laundering Examination Manual 177 (2014).

4. *Licci ex. rel. v. Lebanese Canadian Bank, SAL*, 732 F.3d 161, 165 n.3, 171 (2d Cir. 2013) (internal citations and quotations omitted) (concluding that the repeated use of a New York correspondent bank account, even if the defendant has no other contacts with New York, can be a basis to assert personal jurisdiction).

5. See, e.g., id.at 171; see also *Official Comm. of Unsecured Creditors of Arcapita v. Bahrain, Islamic Bank,* 549 B.R. 56, 72 (S.D.N.Y. 2016).

6. See 31 U.S.C. §5318(i)(1). This section on correspondent banking applies to "covered financial institutions," which include, among others, commercial banks, insured banks, federally insured credit unions, savings associations, certain broker dealers, mutual funds, and agencies or branches of foreign banks in the United States. See 31 C.F.R. §1010.605(e). Covered financial institutions are not necessarily the same as "financial institutions" under the BSA. Compare id., with 31 U.S.C. §5312(a)(2).

7. See 31 C.F.R. §1010.610(a)(2)(i)-(v).

8. See 31 C.F.R. §1010.610(b)(2).

9. Senate Report, at 1.

10. Id. at 35.

11. The Clearing House Association, Guiding Principles for Anti-Money Laundering Policies and Procedures in Correspondent Banking (2016) (Guiding Principles).

12. Id. at 4.

13. Id. at 5-6.

14. Guiding Principles, at 6.

15. See Deferred Prosecution Agreement, *United States v. Commerzbank AG, Commerzbank AG New York Branch*, Attachment B (Statement of Facts) at 7 (D.D.C. March 11, 2015) (hereinafter Commerzbank Statement of Facts); Order to Cease and Desist and Order of Assessment of a Civil Money Penalty Issued Upon Consent Pursuant to the Federal Deposit Insurance Act, as Amended, *In the Matter of Commerzbank AG*, Nos. 15-001-B-FB, 15-001-CMP-FB (March 12, 2015); Consent Order Under New York Banking Law §§39 and 44, *In the Matter of Commerzbank AG, Commerzbank AG New York Branch* (March 11-12, 2015).

16. Commerzbank Statement of Facts at 7-8.

17. Id. at 12 et seq.

18. Id. at 12.

19. Id. at 29-30.

20. Id. at 31.

21. See generally Written Agreement Between Cooperative Centrale Raiffeisen-Boerenleenbank BA, Rabobank Nederland New York Branch, the Federal Reserve Bank of New York, and the New York State Department of Financial Services (June 30, 2015).

22. See Consent Order Under New York Banking Law Sections 39 and 44, *In the Matter of Credit Agricole S.A., Credit Agricole Corporate & Investment Bank New York Branch*, at 10-12 (Oct. 15, 2015).

23. See generally Guiding Principles at 8-27. See generally The Wolfsberg Group, Wolfsberg Anti-Money Laundering Principles for Correspondent Banking (2014); U.S. Dep't of the Treasury and Federal Banking Agencies, Joint Fact Sheet on Foreign Correspondent Banking: Approach to BSA/AML and OFAC Sanctions Supervision and Enforcement (Aug. 30, 2016) (discussing the regulatory and supervisory frameworks of financial agencies that enforce BSA/AML compliance, and explaining the compliance requirements for U.S. banks that maintain correspondent accounts for foreign financial institutions, including risk-based due diligence policies and procedures and assessing the foreign financial institution's markets and business).

24. See Customer Due Diligence Requirements for Financial Institutions, 81 FR 29397 (May 11, 2016).

25. See H.R.4450, Incorporation Transparency and Law Enforcement Assistance Act, 114th Cong. (as introduced to the House Committee, Feb. 3, 2016) and companion measure S.2489 (as read twice and referred to the S. Committee on the Ju-