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DECLINING CORRESPONDENT BANKING RELATIONSHIP IN THE WEST AFRICAN MONETARY ZONE

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Abstract

Declining correspondence banking relationship was a major feature of the banking industry in the Member States of the West African Monetary Zone WAMZ from 2013 to 2016. This objective of this study, therefore, was to clarify our understanding of the drivers of declining corresponding banking relation in the WAMZ. To achieve this objective, we explored the main sources of de-risking in (WAMZ), using questionnaires administered to commercial banks. We document perceived anti-money laundering/combating the financing of terrorism (AML/CFT) concerns and commercial consideration on the part of correspondent banks as the main drivers of de-risking in the WAMZ. Other causes of de-risking include: high compliance and additional requirements demanded by correspondent banks in reflection of an upscale in the legal, regulatory and supervisory requirements in their (correspondent bank's) jurisdictions; lack of full compliance with pre-existing legal, supervisory and regulatory requirements by foreign financial institutions; barriers or bureaucratic nature of communication and information sharing, low level of disclosure on customers, low sovereign credit risk rating and low level of profitability of CBR services. In terms of impact, we noted that the phenomenon affected banks to carry out international wire transfer and some critical banking and money transfer services. The study recommends the need to strengthen existing regulatory and supervisory frameworks, in particular the AML/CFT regime in the Zone.

Key Words: De-risking, correspondent banking relationship, WAMZ, Anti-money laundering, regression analysis, mutual evaluation exercise

JEL Classification: G15, G21, G32

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1.0 INTRODUCTION

Correspondent banking relationship (CBR) is a contractual arrangement between two banks, under which one bank (correspondent) holds deposits owned by other banks (respondents) and provides payment and other services to those respondent banks (BIS, 2016; and Rice et al., 2020). Its significance in the global payment ecosystem cannot be overemphasised, in terms of promoting access to financial services among economies, in particular services such as cross-border payments, cash management in various currencies, international wire transfers, cheque clearing, as well as facilitating global trade, financial inclusion and economic growth (Lawrence and Lougee, 1970; Osterberg & Thomson, 1999). CBRs facilitate transference of remittances, trade finance, encouraging foreign investments by limiting barriers to profit repatriation (Erbenova et al., 2016).

CBR increased phenomenally between 1930s and 2008 due to its importance and growing globalization (Lawrence and Lougee, 1970; Osterberg & Thomson, 1999). For instance, Lawrence and Lougee (1970) highlighted the importance of the unit banking model and the bank holding model to the increase in the number of CBR globally before 1970. Osterberg & Thomson (1999) found that CBR increased globally from 28.18 percent in 1984 to 36.57 percent in 1996. The astronomical increase in CBR between the mid-1990s to 2007 has been attributed to globalization, interconnectedness of financial markets, and the amplitude in migration (Yamamoto,2020). However, after the global financial crises of 2007/2008, CBR pared back from the increasing trend over the years. The adverse effect of the global financial crises which led to change in macroeconomic environments compelled financial institution in developed economies to re-evaluate their business strategy, particularly the cost-benefit analysis of CBR. There were also changes in the regulatory and enforcement landscape, including enhancing prudential requirements and the sanctioning regimes for economic and trade, anti-money laundering and combating the financing of terrorism (AML/CFT) and tax transparency infractions (BIS, 2016). These factors, in addition to the presence of legal impediments to cross-border information, heightened global risk, and lack of clarity on regulatory expectation, may have accounted for the declining CBR globally (BIS, 2016; and FSB, 2016, and 2017), also referred to as de-risking.

The retreat in CBR is broad-based and uneven across countries and regions. Rice et al., (2020) observed that the phenomenon was highest in economies where the governance and controls for illicit financing was weak. Erbenova et al. (2016) observed that regions mostly affected included Africa, smaller emerging markets, the Caribbean, Central Asia, Europe, the Pacific and countries under sanctions. The number of active CBRs globally fell by 6.0 percent from January 2011 to December 2016, with the decline more severe for US dollar and euro denominated currencies, with both falling by 15.0 percent. Further the number of CBRs fell most sharply by 16 percent in Eastern Europe, 12 percent in Oceania and 8 percent in the Americas excluding North America (FSB, 2016). In Sub-

Saharan Africa, so many countries experienced a significant change in CBRs in recent years. Specifically, CBRs declined in South Africa by 10.1 percent, Mauritius by16.0 percent and in Angola by 37.2 percent (Erbenova et al., 2016).

Despite the increasing number of empirical studies on declining CBR in emerging markets and developing economies (Chatain et al., 2018; Alleyne et al., 2018; Alleyne et al., 2017; and Erbenova et al., 2016), studies on declining CBR in the West African Monetary Zone (WAMZ) is lacking. WAMZ economies are not insulated from the second round devasting effect of the global financial crisis as evidence by the challenges confronting banking sector (asset impairments due to oil and commodity price shocks) in the Zone and the sweeping banking reforms undertaken by Nigeria and Ghana, between 2010 and 2018. More so, WAMZ economies are largely informal and rely extensively on cash-based transactions, arising from the low level of financial literacy, high poverty rate that promotes crime, low level of financial technology, especially in rural areas, high presence of designated non-financial businesses and professions (DNFBPs), such as real estate agents, casinos and mining activities. The Zone is also characterised by porous borders with limited capacity of law enforcement agencies to prevent cross-border movements of criminal syndicates involved in drug, human and other predicate offences, deficiencies in AML/CFT regimes, and weak compliance to AML/CFT regimes. For instance, Rice et al. (2020) identified private and public sector initiatives, effective monitoring of compliance to AML/CFT regimes, and massive investment in financial technology are extremely important in reducing frictions in cross-border payments, mainstreaming low-cost cross-border payment channel, and promoting access to safe financial services. How relevant are these recommendations in a Zone with wide digital divide, deficiency in AML/CFT regimes and porous borders with thriving informal cross-border payment channels?

Declining CBRs could exacerbate financial fragilities by limiting cross-border flows to fewer CBRs or the use of alternative arrangements. In the WAMZ the effect of de-risking can be seen in terms of reduction in international trade activities, remittances, investment flows and substantially increase the cost of financial services. Addressing low profitability and risk concerns raised by global banks are factors that may be responsible for the declining CBRs, which would require optimal policy choices and concerted actions by several stakeholders. Given the above peculiarities of the WAMZ economies, relying on findings from other economies might be misleading because of the peculiarities of the economies. This study seeks to investigate the incidence of declining CBR in the Zone. The justification of this study is twofold. First, some of the characteristics of the WAMZ economies have been identified as the factors responsible for declining CBR. A good understanding of the degree of decline in CBR and the economic structures that predispose the WAMZ financial sector to decline in CBR is extremely important for policy formulation.

Second, there is increasing incidences of cross-border banking activities among Member States of the WAMZ, as well as wide variations in the economies. The stark implication of these features is that the degree of declining CBR might not be uniform across Member States, which creates leverage for Member States to use their cross-border banking relationships as a stop-gap, given that the structural rigidities identified as predisposing factors of de-risking might not be resolved in the immediate. For instance, the affected countries relied on countries, where the phenomenon are not huge or for banks under the group arrangement on parent institutions overseas. This study is in response to a directive by the Committee of Governors of the West African Monetary Zone (WAMZ) during its statutory meetings held from July 31 – August 4, 2017 in Monrovia, Liberia, for WAMI, to carry out a study on declining correspondent banking relationship in the Member States of the Zone.

The rest of the paper is structured as follows: Section two reviews the theoretical framework, section three x-rays international experiences on declining CBRs, and Section four focuses on the AML/CFT environment in the WAMZ. Section five analyses the questionnaire data, while Section six concludes the paper with policy recommendations.

2.0 CONCEPTUAL FRAMEWORK

The essential element of correspondent banking relationship involves account opening between a correspondent bank and a respondent bank to exchange messages and settle transactions. In this relationship, the correspondent banks (often a major international bank), provides a deposit or other liability accounts and related services to another bank (respondent bank). The relationship is bilateral and often involves reciprocal cross-border relationship, including payment services in multiple currencies. CBR is an integral part of a well-functioning international financial system, enabling the provision of a range of financial transactions and services, especially third-party payments such as wire transfers, credit card transactions and trade finance.

CBR is an important component of the global payment architecture, because it facilitates cross-border movements of funds, promotes access to financial services in different jurisdictions and currencies, remittance flows and commerce, arms giving, and enabling international trade, which are critical to promoting financial inclusion (FATF, 2016). It involves different types of bank products and services, such as foreign exchange services, letters of credits, loans, check clearing, management services, among others (BIS, 2015).

There are three variants of CBR service delivery. First, the traditional or indirect CBR, where a correspondent bank enters into a contractual relationship with a respondent on behalf of its customers. Under this model, the business transaction between the correspondent bank and customers of the respondent bank is indirect since the latter do not have direct access to the correspondent account. Second, the nested CBR, an arrangement that allows several institutions or respondent banks to transact businesses using a bank’s correspondent relationship. This is the arrangement the WAMZ Member States contemplated at some point, which is allowing banks in other countries to access CBR services via banks in Nigeria and Ghana that have not witnessed declining CBR. The third type is the payable-through account, also generally referred to as “pass-through” or “pass-by” (p.8). It is slightly different from nested account, in the sense that customers of the respondent bank are allowed to directly access the correspondent account to transact business on their own behalf. (BIS, 2015).

Correspondent banking play significant role in enhancing growth through the provision of a platform for the settlement of obligations arising from domestic and international trade. However, the process of intermediation by the correspondent banks have its attendant risk factors. In managing this, global banks often withdraw their CBR as de-risking strategy. While some authors use the term 'de-risking' to describe banks' effort to mitigate business and reputational risks, others believe that any form of withdrawal of financial services could be interpreted as de-risking. The decision to terminate CBRs could be influenced by a banks' cost-benefit analysis. The analysis could take into consideration the macroeconomic fundamentals of a particular jurisdiction such as the regulatory environment in terms of provisions and enforcement of relevant laws and prudential requirements, including AML/CFT, and tax transparency (Erbenova et al., 2016). Reciprocal CBR may involve the use of nostro (bank A's deposits with another bank) and vostro (another bank's deposit with bank A) accounts.

3.0 EXPERIENCES OF OTHER JURISDICTIONS

In the aftermath of the 2007/2008 global financial crises, declining CBRs assumed a global dimension. The trend, however, was uneven across the regions of the world with the Caribbean, Central Asia, Europe, smaller emerging market and developing economies in Africa and countries under sanctions being the most affected (Erbenova et al., 2016). In terms of value of transaction, the largest declines in CBRs were observed in Euro Zone countries facing economic stress (Cyprus and Greece), fragile states under sanctions or plagued by conflicts (such as Chad, Syria, Ukraine, and Yemen) and some island states (Dominica, Timor-Leste, and Seychelles) [IMF, 2017]. While no clear trend was observed in terms of the volume and value of CBR transactions, data on the number of correspondent banks and the value of transactions between 2012 and 2015 showed a decline (IMF 2017). The decline was pronounced in northern and partly southern Africa.

Apart from Central America, the greater part of America saw similar declines in the number of correspondent relationships (FSB, 2016). In Asia, however, after the decline in 2012, the number of CBRs increased for the most part. For the period 2012-2015, only Western Asia witnessed significant reductions in CBR, partly due to the political crisis in Syria. CBRs fell steadily in Europe in reflection of the sovereign debt crisis. Essentially, some big European banks gradually substituted CBRs for low-volume/high-value payment transactions in the wake of the Single Euro Payments Area (FSB, 2016).

The Caribbean banking sector also experienced de-risking. A survey of more than 300 banks and payment data from SWIFT reported about 10 percent decline in CBR in Caribbean and the Pacific areas (Melanesia, Micronesia and Polynesia) in 2016 alone (IMF, 2016). According to the 2016 IMF survey, the loss of CBRs in these countries had increased both explicit costs (charges for provision of CBRs) and implicit costs (upscale in due diligence efforts, enhanced AML/CFT compliance regime and employee training costs) of maintaining existing ones substantially. These costs, the report noted, were transferred to customers of these banks, especially for wire transfers and foreign currency drafts.

In Sub-Saharan Africa CBRs declined by 10.1 percent in South Africa, 16.0 percent Mauritius, and 37.2 percent Angola, while Nigeria and Kenya witnessed increase in CBRs by 2.5 percent and 10.1 percent respectively, between 2013 and 2015 (SWIFT, 2016). A study by Bank of Sierra Leone (BSL) indicates that some banks in Nigeria have de-risked from other banks or financial service providers in Africa observed to be high risk. The study notes that Bureau de change businesses are among the relationships mostly affected, with the closure of most businesses in the country while those attempting to establish new ones have been subjected to stringent requirements.

4.0 AML/CFT ENVIRONMENT IN THE WAMZ

In general, the most suggested reason for withdrawal of correspondent banking relationship are AML/CFT compliance-related issues (IMF 2017). In 2012, the Financial Action Task Force (FATF) updated the AML/CFT international standard and broadened the assessment criteria, placing greater focus on a risk-based approach to AML/CFT examination. Most correspondent banks cited increased compliance costs, low profit expectations as well as enormous fines and diminished reputation for AML/CFT infractions as major reasons for the withdrawal of CBR services (World Bank, 2015). In most jurisdictions of respondent banks, weaknesses in their legal and regulatory frameworks, Customer Due Diligence (CDD) procedures and higher business risks constitute potential channels of AML/CFT risk exposures (IMF, 2017).

Generally, WAMZ Member States are susceptible to money laundering activities, owing to the characteristics of the economies, especially their relatively large and cash-based informal sector, with high inroads by designated non-financial businesses and professions (DNFBPs), such as real estate agents, casinos and mining activities. The development is reinforced by the presence of weak borders with limited capacity of law enforcement agencies to prevent cross-border movements of criminal syndicates involved in drug, human and other predicate offences. Analysis of the AML/CFT environment in the WAMZ reveal that while most WAMZ Member States in recent times have strengthened their AML/CFT regimes, quite a lot remains to be done.

The Gambia introduced and commenced the implementation of currency transaction and foreign wire transfer transaction reporting regime to broaden the base of information available to The Gambia Financial Intelligence Unit (GFIU) for analysis. Steps taken by the country in setting up a credible AML/CFT regime include: enactment of relevant laws and regulations, establishment of an independent Financial Intelligent Unit (FIU), development and issuance of AML/CFT guidelines and continuous capacity building, and FIU issuance of directives to all other stakeholders. Also, the country has enhanced its national coordination and collaboration through regular meetings of the AML/CFT Inter-Ministerial Committee. It also established a cross-departmental Task force to trace and return stolen assets of the country and enhanced the capacity and effectiveness of GFIU, as well as strengthened oversight of financial institutions.

In a bid to improve of KYC-CDD measures, the Central Bank of The Gambia (CBG) carries out regular evaluation and assessment of existing policies, guidelines and procedures, like the issuance of new guidelines to reporting entities. The CBG in collaboration with the FIU issued new guidelines, to serve as a guide to FIs licensed by the CBG. The aim is to provide financial institutions with requisite knowledge, deeper interpretation and understanding of the requirements and obligations of the AML/CFT Act 2012, including correspondent banking, cross-border wire transfers and technological developments. At end-December 2018, the Inter-Governmental Action Group against Money Laundering in West Africa (GIABA) maintained The Gambia on the Expedited Regular Follow-up Process because of areas that needed urgent improvement. For instance, The Gambia was yet to commence supervision of DNFBPs for AML/CFT, due to the absence of comprehensive legal and appropriate guidelines that criminalises market manipulation. The country was also yet to enact important drafted bills to address the outstanding legal deficiencies. Among them included: Anti-Money Laundering and Combating Terrorist Financing for Financial Institutions in The Gambia (2016), Anti-Money Laundering and Combating Terrorist Financing for DNFBP (2016), Money Laundering and Terrorist Financing Examination Manual for Financial Institutions, and Anti-Money Laundering Risk Assessment and Self Risk Assessment Guideline for Reporting Entities.

Ghana has made substantial progress in the fight against ML/FT following the passage of the Anti-Money Laundering Act, 2008 (Act 749), the Anti-Terrorism Act, 2008 (Act 762) and the Anti-Money Laundering Regulations, 2011 (L.I.1987). In April 2009, Ghana went through the First Round of Mutual Evaluation exercise with GIABA to assess the country's AML/CFT regime. The Mutual Evaluation Report (MER) adopted during the November 2009 GIABA Plenary, identified some deficiencies including non-existence of an operational Financial Intelligence Unit (FIU) in Ghana, despite such provisions in the Anti-Money Laundering Act, 2008 (Act 749), ineffective application of powers by appropriate authorities, and discrepant application of currency declaration system across designated points of entry and exit. The rest included weak adherence to relevant preventive measures in relation to KYC-CDD and Politically Exposed Persons (PEPs), absence of risk-based approach to AML/CFT examination, weak monitoring of domestic and cross-border wire transfer services, and lack of guidance on the use of third parties and intermediaries.

Consequently, Ghana developed a comprehensive National Strategy and Action Plan for the Countering of Money Laundering and Financing of Terrorism (2011-2014), by providing a broad framework for strengthening the legal, institutional, enforcement mechanism in the AML/CFT regime. In September 2014, following the directive issued at the May 2014 GIABA Plenary held in Niamey, Niger, the AML/CFT National Risk Assessment (NRA) blueprint was launched and the report was subsequently published in August 2016. The NRA provided the framework for prioritising and efficiently allocating resources to effectively address AML/CFT deficiencies in the country. The successful implementation of National Strategic and Action Plan and the launch of the NRA led to the passage of a number of legislations and guidelines. The legislations and guidelines include the Companies (Amendment) Act, 2016 (Act 920), Executive Instrument, 2016 (E.I. 114), Banks and Specialised Deposit-Taking Institutions Act, 2016 (Act 921), Anti-Money Laundering (Amendment) Act, 2014 (Act 874), Anti-Terrorism (Amendment) Act, 2014 (Act 875). The rest include Executive Instrument 2, 2013 (E.I. 2), Anti-Terrorism (Amendment) Act, 2012 (Act 842), Anti-Terrorism Regulations, 2012 (L.I. 2181), Criminal Offences (Amendment) Act, 2012 (Act 849), Economic and Organised Crime Office (Operations) Regulations, 2012 (L.I. 2183), Anti-Money Laundering Regulations, 2011 (L. I. 1987), and the development of various AML/CFT Guidelines in collaboration with respective Supervisory and Regulatory Bodies for Banks, Insurance Companies and Capital Market Operators.

In September 2016, Ghana conducted a Second Round of Mutual Evaluation exercise and the report was adopted by GIABA Technical Commission/Plenary Meetings held in Monrovia, Liberia in May 2017. In the banking industry, there exist strong cooperation and collaboration between the Bank of Ghana (BoG) and the Financial Intelligence Centre (FIC) on matters of AML/CFT regulation, supervision and enforcement actions. Therefore, in line with section 6(d) of Act 749 and Regulation 38 of L.I.1987, in 2018 BoG and FIC jointly developed and issued an AML/CFT Guideline for financial institutions licensed by the Bank of Ghana. The Guideline provided ample guidance for financial institutions and covered the essential elements of the AML Act (Act 749) and Regulations, relevant FATF-Recommendations, the core principles of the Basel Committee on Banking Supervision and other international best practices on AML/CFT. BoG has developed a risk-based approach to the supervision of banks and other financial institutions under its remit.

Guinea has made steady progress in strengthening AML/CFT regime. The country has taken concrete steps to enhance its compliance with the FATF standards with the passage of the law against Corruption and Related Offences. The country also established the Authority in Charge of administrative freezing; appointed the members of the Advisory Committee on Administrative Freezing (CCGA) and developed relevant measures and procedures (under Decree D/2015/191/PRG/SGG), including the mode of referral to the Authority; the dissemination of freezing orders; requests from third countries; and penalties for offenders. It has developed a four-year action plan covering the period 2017-2020, which has been approved by the Technical Committee of GIABA. Guinea is on expedited regular follow up process.

Liberia has taken appreciable steps to strengthen AML/CFT regime. These include: revision and republishing of the Anti-Terrorism Act, 2017, and the Targeted Financial Sanctions against Terrorist Acts, 2017. The FIU Liberia have issued four (4) guidelines on AML/CFT, provided training and guidance to Mobile Money Service Providers, commenced collaboration with other competent authorities on AML/CFT supervision of the Non-Profit Organisations (NPOs) and gaming sectors, and trained various AML/CFT stakeholders. The country has also developed a national action plan with specific timelines to implement all the recommendations, and the country expects to complete the action plan by February 2019.

The Anti-Terrorism Act has been passed by the National Legislature. It is broken down into three separate acts. The first, Liberia Anti-Terrorism Act, criminalises the financing of individual terrorists for any purpose, without requiring a link to a specific terrorist act, among others. The Special Criminal Procedures for Offenses involving Terrorist Acts, provides law enforcement agencies with powers to identify and trace property marked for confiscation or suspected to be the proceeds of crime, among others, and the Targeted Sanctions against Terrorist Acts designates competent authority responsible for proposing designations to the UN and for making designations at the national level, and review the mechanisms in place to handle foreign requests, among others.

The Central Bank of Liberia (CBL) has established a unit in the Regulation and Supervision Department with specific focus on strengthening and building examiners expertise in the area of AML/CFT. In addition, the CBL has made significant progress in promoting the AML/CFT standards in Liberia. CBL has developed an AML/CFT Examination Manual to be used by examiners during on-site examination processes. The examination manual, which generally adopts a risk-based approach to supervision, provides step-by-step guidance to examiners during onsite examinations; ensure compliance with the AML/CFT Act, 2012; the Central Bank of Liberia (CBL) AML/CFT Revised Regulation No. CBL/RSD/002/2017; as well as regulations, directives and circulars issued by the FIUL and the CBL. CBL held introductory meeting with Heads of Insurance Companies concerning issues of AML/CFT that affect the industry and trained both examiners and compliance officers of commercial banks on the use of the Examination Manual and the AML/CFT examination processes and the expectation of examiners, respectively.

Despite the improvement made by Liberia with its AML/CFT regime, the country is yet to show commitment and evidence of money laundering convictions. Also, Liberia needs to ensure that non-bank financial institutions and DNFBPs are monitored for compliance with AML/CFT obligations. This includes developing and issuing AML/CFT examination manuals for all Non-Bank FIs, especially insurance companies and mobile money service providers. Also, the country still has work to do to revise, amend and enact relevant laws and regulations (on asset tracing, mutual legal assistance and extradition, asset forfeiture, sharing of terrorist assets with other countries, legal persons and arrangement, NPOs, politically exposed person, and DNFBPs). Liberia according to GIABA still need to conclude the Standard Operations Procedures Manual for the FIU and ensure that competent authorities maintain statistics in accordance with recommendation 32. GIABA maintains Liberia on the Expedited Regular Follow-up Process.

Nigeria has continued to show commitment in its efforts at improving its AML/CFT regime. For instance, Nigeria has establishment specialised anti-corruption and Law Enforcement Agencies (LEAs) such as the Economic and Financial Crimes Commission (EFCC), the Independent Corrupt Practices and other related offences Commission (ICPC), the Code of Conduct Bureau (CCB) and Department of State Services (DSS); and had sought to enact relevant laws and strengthen the collaboration among these stakeholder institutions in the fight against ML and FT. On August 17, 2015, the Government constituted a Presidential Advisory Committee on Anti-Corruption to spearhead the anti-corruption agenda of the country. In line with recommendation 1 of FATF, the country carried out a National ML/TF Risk Assessment (NRA) in 2016 to outline the national and sector risk exposure levels to ML & TF. The assessment gave Nigeria a Medium High rating. Consequently, an action plan to address the identified ML/TF risks, including implementing a Risk Based Approach (RBA) AML/CFT compliance function was developed.

With respect to banks and non-bank financial institutions, the Central Bank of Nigeria (CBN) is responsible for the implementation of AML/CFT rules and recommendations. The Bank conducts AML/CFT off-site examinations to ensure that the recommendations of FAFT-F were complied with. Information sharing and coordination with AML/CFT stakeholders improved under the auspices of the Financial System Regulation and Coordinating Committee (FSRCC). Access to justice was also expedited with the Chief Justice of Nigeria's directive that AML/CFT related cases should be heard within six (6) months.

In Sierra Leone the AML/CFT intelligence Committee was constituted in November 2015 in addition to the Central Security and intelligence Unit (CSIU) to reinforce the fight against money laundering and terrorism. In 2013, Sierra Leone enacted a regulation, including establishing a Terrorism Prevention Committee, for the implementation of United Nation Security Council Resolution (UNSCR) 1267 and 1373. The regulations provided the legal framework for the distribution of the list of designated persons and organizations, freezing of funds of criminal syndicates and set out the conditions under which frozen funds can be used, unfreezing procedures, delisting of individuals and organizations as well as the reporting obligations, penalties and sanctions for non-compliance.

Other steps undertaken included, ratification of the Palermo Convention which reaffirms the country's commitment to the global fight against transnational organised crime, augmenting the resource and operational capacity of the FIU to enable it perform its core functions of receiving and analysing information relating to money laundering and terrorism financing and disseminating the resulting intelligence to law enforcement agencies for investigations and possible prosecutions, application for membership of the Egmont Group of FIUs to facilitate information sharing with other FIUs across the world and strengthen international drafting of Directives and Guidelines on the Prevention of Money Laundering and Terrorism Financing, including providing guidance on the implementation of risk-based approach to AML/CFT supervision, as well as relevant spectrum of AML/CFT requirements such as KYC-CDD measures, reporting of suspicious transactions, record keeping as well as the United Nations Security Council's resolutions.

Over the years, the FIU in collaboration with BSL has conducted onsite examinations of commercial banks to ensure compliance with AML/CFT requirements relating to KYC/CDD, identification of politically exposed persons, reporting of suspicious transactions, determining the adequacy in the AML policies of financial institutions, internal control measures and documentation relating to wire transfers associated with the importation of goods. The compliance of AML/CFT requirement has been extended to non-bank financial institutions, including regular engagement with foreign exchange bureau operators. While the FIU continues to strengthen its domestic cooperation with relevant principal intelligence and law enforcement agencies through the establishment of an AML/CFT Inter-Agency Intelligence Coordinating Committee and membership of the FIU in the Transnational Organized Crime Unit and the Joint Intelligence Committee, it also engaged the Sierra Leone Bar Association to ensure that members of the legal profession comply with AML/CFT requirements and the General Legal Counsel regulates and supervises compliance. The FIU has signed Memorandum of Understanding with thirteen (13) FIUs in Africa, mostly from the West African sub-region to facilitate information exchange and cooperation in combating money laundering and terrorism financing offences.

Despite the progress made in recent years to enhance the country's AML/CFT regime, the system is still deficient in compliance with international standards. Owing to these deficiencies, a decision was reached at GIABA Plenary Session held in Praia, Cape Verde in May 2016 that Sierra Leone should be retained on the expedited regular follow-up process. The deficiencies identified in the thirteen (13) GIABA follow-up report of Sierra Leone included: non-criminalisation of Terrorism offence, insider trading and market manipulation as a predicate offence of money laundering, ineffective implementation of AML/CFT requirements relating to non-bank financial institutions such as foreign exchange bureau, and absence of a competent authority to regulate and supervise DNFBPs such as casinos to oversee gaming operations and related financial transactions to prevent ownership, control or operation of these entities by criminal syndicates. It was also noted that the effectiveness of the AML/CFT law was yet to be tested through the prosecution of cases relating to money laundering or terrorism financing offences, and there was no framework to manage and/or dispose of property frozen, seized or confiscated such as an asset forfeiture fund.

While current efforts by the FIU in collaboration with relevant stakeholders have significantly enhanced the country's AML/CFT compliance regime, there are no doubts that Sierra Leone is still perceived by global banks not to be fully compliant with international standards on AML/CFT.

5.0 ANALYSIS OF QUESTIONNAIRE

5.1 Data and Descriptive Statistics

The study employs survey based primary data to provide explanations on how development and status of CBRs in the WAMZ, are responsible for the termination and/or restriction of the CBRs, effects on clients' services, products, and an assessment of countries ability to find replacement when a CBR is lost. This was done through administration of questionnaires to various commercial banks through the central banks of the six (6) WAMZ Member States. The questionnaires were distributed to eighty banks in the six (6) countries. A total of 80 questionnaires were administered to the six central banks in the zone out of which 60 were returned, representing 75%retrival rate (Table 1). The retrieval rate was highest in Sierra Leone (93.3%) followed by Ghana (90%) and lowest in The Gambia at 50%.

Table 1: Questionnaire Retrieval Rate in the WAMZ

Questionaire	Gambia	Ghana	Guinea	Liberia	Nigeria	Sierra Leor	Total
Administered (No	10	10	15	15	15	15	80
Returned (Nos)	5	9	12	9	11	14	60
Retrival Rate (%)	50.0	90.0	80.0	60.0	73.3	93.3	75.0

A descriptive analysis of the survey data is carried out on five issues – developments and status of CBRs, factors driving the termination and/or restrictions of impact on clients' services, product and services; ability to find CBRs replacement.

5.2 Developments and Status of CBRs in the WAMZ

The analysis revealed mixed results. While some countries had experienced significant loss in their CBRs, the development had been minimal in others. In The Gambia, 80.0 percent of the banks had experienced significant decline in their CBR. Though 20.0 percent stated that they have not recorded any significant change, the analysis suggests the need for further investigation to understand the driver of such level of decline in CBRs in the country. The case of Ghana showed that most banks did not experience any significant change in the level of CBR. While 88.89 percent of respondents affirmed this position, 11.11 percent of respondents, mostly new entrants, reported decline in the level of CBR. Overall, the development seems to be less pronounced in Ghana.

The situation in Guinea showed that 16.67 percent of the respondents experienced an increase in CBR while 41.67 percent witnessed a decline. The remaining respondents reported no significant change. In Liberia, 66.67 percent of respondents reported significant decline in CBRs, 22.22 percent reported no change while 11.11 percent reported an increase. In Nigeria, 81.82 percent of respondents reported that there was no significant change in the level of CBRs. Though, no bank indicated an increase in CBR, 18.18 percent indicated that they experienced decline. Lastly, 64.29 percent of respondents in Sierra Leone reported a decline in CBRs, 7.14 percent indicated no significant change, while 28.57 percent indicated an increase.

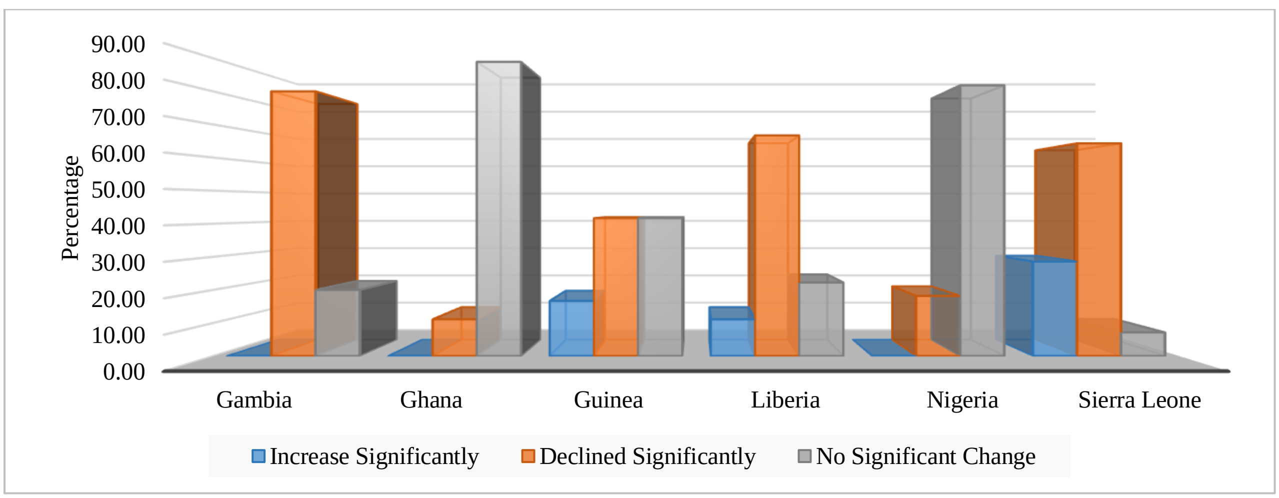

Figure 1: Status of Correspondence Banking Relationship in the WAMZ at end-June 2017

5.2.1 Factors Driving the Termination and/or Restriction of CBRs

To uncover the root cause of the loss of CBRs in the Zone, a major question posed was for the relevant institutions to identify the probable causes of the termination of CBRs.

In The Gambia, the main drivers of the decline in CBRs include: perceived money laundering /terrorism financing; general decline in risk appetite of foreign financial institutions and the lack of confidence in the respondent bank's capacity to effectively manage risks; changes in the legal, regulatory and supervisory requirements in foreign financial institutions jurisdictions which have implications for maintaining CBRs; and lack of full compliance with pre-existing legal, supervisory and regulatory requirements by foreign financial institutions. Other identified causes are the barriers or bureaucratic nature of communication and information sharing and low level of disclosure on customers. The sovereign credit risk rating of The Gambia as well as the low level of profitability by the foreign correspondence banks also contributed to the withdrawal of CBRs services.

In Ghana, the proportion of banks that were affected by the decline in CBRs cited the following as the causes: inability to undertake proper Customer Due Diligence (CDD) on financial transactions, and decline in profitability of some foreign correspondence banks' services. For banks in Guinea, the following reasons were proffered as possible causes for decline in CBRs, including: strategic deficiencies in compliance with AML/CFT rules; changes to rules and regulations guiding the operations of foreign financial institutions playing as correspondence banks, and lack of profitability of certain foreign CBR products.

In Liberia, the cause of decline in CBRs was significantly a business decision by correspondent banks to withdraw their services. Other factors include deficiencies in the implementation of AML/CFT regime of the country and lack of presence. In Nigeria the banks stated that overall risk appetite of the foreign financial institutions and sovereign credit risk rating of Nigeria were the most significant drivers in CBRs decline. In Sierra Leone, the responses indicated weak compliance with the AML/CFT requirements, and additional requirements by the correspondence banks in carrying out Customers' Due Diligence (CDD) due to the existence of some strategic deficiencies in the AML/CFT legislations in Sierra Leone.

5.1.2 Impact on clients' services, product, and services

This question was designed to gauge the impact of account termination and restrictions on the services rendered by the banks. In **The Gambia,** nine (9) out of the twelve (12) banks that experienced loss in CBRs, reported loss of their Nostro accounts held. Specifically, these banks loss, on average, five (5) Nostro accounts from 2013 to 2016. Despite the decline in the CBRs, the volume of transactions remained unchanged, however, the processing speed continued to slow down due to compliance requirements and additional charges. In **Ghana,** the affected banks experienced difficulties in terms of international wire transfer and trade finance activities. One of the banks reported that they were worst hit as it affected a lot of their services, such as clearing and settlement, cash management services, investment services foreign exchange services, among others. During the period 2013 – 2016, these banks could not carry out Money Transfer Operators (MTOs) and other forms of remittance for their customer, invariably leading to reduction in profitability.

In the case of **Guinea**, affected banks reported that the development hampered their operations in terms of international clearing and settlement, cash management, trade and investment services, among others. By implication, the banks added that remittances could not be done for their customers and this also had negative implication on the small and medium scale exporters. The analysis of the questionnaires revealed that banks in **Liberia** suffered various magnitude of scuffled relationship with their correspondent banks during the period under consideration. For instance, three (3) out of the nine (9) banks in Liberia reported loss of CBRs with the U.S (and/or Western) banks. Further, about eleven (11) accounts of five (5) of the banks with U.S (and/or Western) banks were terminated. In the same vein, one (1) bank reported that all applications it had made in the last three years for correspondent banking relationship with the U.S. (and/or Western) banks have been declined.

Given that banks in **Liberia** rely on non-interest income of which fees and commission from money transfers is a major part, this poses serious threat to profitability. The loss of correspondent banking relationship has also led some banks to maintain significant portion of their foreign currency holdings with related institutions such as parent companies in the WAMZ. Given the adverse economic developments in some countries in the Zone, significant exposures to banks in the Zone, a development that could exacerbate the contagion risk on the subsidiaries operating in Liberia.

Nigeria though less affected reported three (3) cases, out of the twelve (12) responses, where the impact of the withdrawal of the CBRs was significant and with serious consequences on the scale and breadth of their foreign related transactions. For instance, one of the three (3) banks that indicated loss of CBRs has had eighteen (18) Nostro accounts terminated; another reported the termination of three (3) of such accounts, while two (2) were restricted; the third bank reported that five (5) accounts were terminated while fourteen (14) where restricted. The accounts terminated/restricted were mainly related to clean trade lines. The respondents indicated that banks that terminated accounts were mainly based in Europe and USA except for one account terminated by banks in South Africa and Mauritius, respectively. Out of the three respondents that recorded significant decline in CBRs, one stated that the decline affected its foreign currency capital and current accounts significantly, while another said that only its US operations were affected significantly. The third respondent stated that it is Europe and Asia operations were affected significantly. The responses indicated that the effects were idiosyncratic on the banks. Clearing, Investment Services, Trade Finance, Lending and Structured finance were highlighted as the banks' products and services that were significantly affected because of decline in CBRs.

In **Sierra Leone**, about 70.0 percent of respondents admitted that the withdrawal of CBRs has had moderate/significant impact on their services, particularly on transactions involving transfer across national borders. In terms of the relative impact on their various services such as international wire transfers, clearing and settlements, and cheque clearing; it ranges from 40.0 to 60.0 percent. This development becomes worrisome considering the import dependent nature of the economy. We reinforced the findings of the descriptive results with the pooled regression.

5.1.4 Ability to find CBRs replacement

The study measured the ability of banks in the WAMZ to secure replacements for the loss of CBRs. In **The Gambia**, the situation was mix as some banks were able to find alternative correspondent banks, others find themselves cut off entirely due to the huge cost and time required to secure a new relationship. Even where new relationships were found, they were mostly based on less favourable terms and conditions. Four (4) affected banks stated that they were unable to find replacement. Banks which experienced de-risking in **Ghana** reported that they were able to find replacement. For instance, a bank explained that when its relationship with Deutsche Bank of USA was terminated due to risk appetite in Africa, it had no impact on its operations because an alternative was found immediately. Similarly, in Guinea, affected banks were able to find alternative, including using the central bank, without the loss affecting their operations in any way.

In the case of **Liberia**, four (4) banks reported that they were able to secure and establish new correspondent banking relationships. In **Nigeria**, one of the affected banks responded that it was able to find a replacement for the terminated CBR, though the process was difficult. In another instance, the alternative CBR did not have the level of processing speed and spread or coverage of the lost relationship.

Evidence from the questionnaires suggested that most banks in Sierra Leone could not find replacements following the termination of their CBRs; only two (2) out of the ten (10) banks (20 percent) that had their CBRs terminated responded that they were able to find alternative correspondent banks. As a result of the difficulty in securing an alternative CBR, a bank which had a significant share of the market, in 2016 was only guaranteed by its parent bank to support only outflows into its customers' account for two months. Additionally, such transactions would be honoured if it complied with the KYC/CDD requirements of the home (parent bank's) regulator. Affected banks in **Sierra Leone** resorted to using alternative arrangements such as engaging parent banks in other jurisdictions to serve their customers. About 70.0 percent resorted to channelling transactions through their parent banks overseas.

6.0 **CONCLUSION AND POLICY RECOMMENDATIONS**

6.1 Conclusion

The study aimed at providing insights into the underlying causes of the termination of correspondent banking relationships in the WAMZ. We employed both qualitative and quantitative methods over the period 2013 – 2016. A questionnaire was designed and self- administered to capture causes and likely impact of the de-risking on affected banks in the Zone. This was also complemented with a pooled regression analysis. Response rate by Member States were high, which contributed largely to improving the robustness of the findings. Specifically, the study delved into the development and status of CBRs in the WAMZ, factors responsible for the termination/restriction of the CBRs, effects on clients' services, products, and an assessment of the ability of affected banks to find a replacement for lost CBRs.

The investigation revealed that incidences of terminated CBRs are more pronounced in The Gambia, Liberia, and Sierra Leone, mild in Guinea, and less significant in Ghana and Nigeria. We noted from the responses that, AML/CFT compliance concerns and low risk appetite for the region were the major factors responsible for the loss of CBRs. Also, some correspondent banks went through restructuring and adjustment of operational regulations, among others, in their jurisdictions, which prompted them to reassess their correspondence relationship and hence, termination of correspondence banking relationships.

The loss of CBRs it was noted had negative impact on the services of affected banks. The responses showed that the ability of affected banks to carry out international wire transfer was greatly curtailed. Trade finance, clearing and settlement, cash management services, foreign exchange services, and crucial banking services were hampered during the period. Further, MTOs and other forms of remittances that contribute significantly to banks' profitability were greatly affected. We also found mixed response in terms of affected banks ability to find replacements for their loss relationships.

De-risking, while variable in terms of impact on Member States, could have potential systemic consequences for the Zone. The suggested policy response is therefore advocated to mitigate further severing of these relationships and its associated economic consequences.

4.1 Policy Recommendations

De-risking or declining correspondent banking relationship, while varying in terms of significance and impact among Member States of the WAMZ, remains a challenge. The study uncovered that de-risking excluded many local economic agents (financial institutions, corporates, exporters, and importers) in WAMZ Member States from formal international trade and financial system. The affected banks were impacted in terms of their inability to carry out international wire transfers, remittances and money transfer operations, trade finance, investment services, among others. Most of these banks lost their nostro accounts, experienced delayed transaction processing due to compliance requirement, increased compliance costs, loss of customers (mostly importers, exporters and corporate clients), and loss of profitable commercial ventures. Even though finding replacements for severed CBRs were varied among respondents, with most banks being able to make alternative arrangements, however, we noticed that the switching or searching cost of new CBRs were high. While the study did not delve into the macroeconomic effect of de-risking in the WAMZ, at the micro-level, the effects were more disruptive in domestically controlled banks, in terms of the ability to make payments and have continuous access to other important banking services, relative to foreign-controlled banks, who leveraged on their groups and parent companies.

The study further documented, based on the responses from the banks that, perceived AML/CFT concerns and commercial consideration on the part of correspondent banks were the main drivers of de-risking in the WAMZ. Other causes of de-risking include: high compliance and additional requirements demanded by correspondent banks in reflection of an upscale in the legal, regulatory and supervisory requirements in their (correspondent bank's) jurisdictions; lack of full compliance with pre-existing legal, supervisory and regulatory requirements by foreign financial institutions; barriers or bureaucratic nature of communication and information sharing, low level of disclosure on customers, low sovereign credit risk rating and low level of profitability of CBR services.

The current de-risking phenomenon could lead to concentration of CBRs among few correspondent banks with risk appetite in the WAMZ. As affected banks in these jurisdictions strive to secure replacements or ride-on or utilise big banks or banks in a group structure operating in the Zone or operate through nested accounts, these correspondent banks may be forced to scaleup compliance requirements or even seek to activate "KYCC" (Know Your Customer's Customer), increasing the compliance cost burden for both respondent banks and the correspondent bank. This could further deepen the scale of de-risking besides commercial considerations, and hence warrants the urgent need for Authorities to intervene to stem this brewing tide of termination of CBRs in the Zone.

In the first instance, it would be expedient to clarify the regulatory expectations of jurisdictions hosting correspondent banks in the light of the changes in their legal, regulatory and supervisory requirements, which have triggered de-risking. While the FATF recommendations establishes requirements regarding AML/CFT, which essentially must be considered, Member States regulators should also engage regulators of these correspondent banks to get more information and understand the relevant requirements and communicate same to their institutions for compliance. Continuous dialogue and accurate flow of information with regulators and correspondent banks could help bridge information asymmetry induced de-risking.

Secondly, Member States should also strengthen their AML/CFT regimes, given its significance as a causative factor of de-risking in the Zone, placing much emphasis on risk-based approach to AML/CFT supervision. Known deficiencies especially those highlighted in Mutual Evaluation reports must be conscientiously addressed to strengthen the AML/CFT regime in the Zone. It is obvious that the exclusion of economic agents from formal international trade and financial system through de-risking could breed unregulated and opaque channels to achieve similar objectives (FATF 2014). However, WAMZ Authorities should put in place measures such as appropriate regulation, supervision and enforcement actions to ensure that such practices do not fester (as it can illicit more ML/FT activities). Banking regulators must place greater emphasis on client on-boarding processes (CDD-KYC measures), and deal with weaknesses in systems and controls in banking operations, which has implications for ML/FT. This would also mean bank supervisor should consider AML/CFT operations as one of the several factors in the risk assessment mechanism (significant activity in the risk matrix) in their risk-based supervision framework. Other measures that can assist in the proper profiling of customers such as unique customer identity system by banks, proper addressing system, and national identification systems must be provided.

Where feasible, central banks should encourage banks to established more than one CBRs, notwithstanding its associated cost implication. This decision should, however, be highly informed by commercial viability of maintaining business relationship and cost of maintaining multiple CBRs. Regulators should also identify and closely monitor vulnerable banks (especially new entrants, domestic controlled and smaller banks) likely to experience de-risking and place them on an enhanced supervision risk radar or watchlist, so as to increase awareness at senior levels as well as scale up the level of supervision. In addition, regulators can provide guidance on the development of contingency planning for banks as fallback plan should the risk crystallise.

Also, under the WAMZ agreement and utilising the College of Supervisors of the WAMZ (CSWAMZ) platform, continuous cooperation, and collaboration in terms of information and experience sharing on the concept of de-risking is highly encouraged. Member States can learn valuable lessons on the phenomenon from each other and work together as a sub-regional bloc on how to resolve the situation. The CSWAMZ platform could be used to encourage Member States' adoption of the Model Act for Banks and Financial Holding Companies, a legislation developed to help harmonise the legal and regulatory frameworks in the Zone. Once adopted, there would be consistency and parity in regulatory and supervisory processes, which would facilitate cross-border supervision.

To analyse the questionnaires, the study used descriptive analysis, and complemented it with pooled regression. The descriptive tools used are simple percentages, tables, and bar chart. The Pooled Ordinary Least Square (OLS) regression was also used to analyse the data.

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