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Safeguarding Trade Transactions and Prevention of Trade Based Money Laundering: Role of Correspondent Banks

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Foreword

As part of the ongoing dissemination of BIBM research outputs, this keynote paper of the roundtable discussion contains the results and findings of the research paper titled “Safeguarding Trade Transactions and Prevention of Trade Based Money Laundering: Role of Correspondent Banks”. The findings of the roundtable discussion topic titled are presented as part of the ongoing dissemination of BIBM research outputs. The research was presented in an online session held on the Zoom platform on 7 June, 2023. Domestic banks employ correspondent banks to conduct transactions, access foreign markets, and service overseas customers without branches. It facilitates international trade finance and efficient worldwide financial systems as a vital part of the global payment system. Shell banks have complicated correspondent banking ties. Though the crucial roles of correspondent banking relationships necessitate understanding the limitations of the current correspondent banking relationship by regulators, banks, and financial institutions, the importance of correspondent banking means regulators worldwide want to ensure safe and efficient functioning by handling any potential threats. The report also highlighted problems for banks implementing correspondent relationships and offered solutions.

This paper has been finalized after incorporating the valuable comments and suggestions of the distinguished panelists, participants of different banks and the academicians joined in the roundtable discussion held on this topic.

It gives me immense pleasure to publish and distribute this research paper to the policymakers, practitioners, academics and common readers. I hope this will be a useful treasure of knowledge to understand as well as to overcome the challenges of correspondent banking relationship in cross-border transaction in Bangladesh.

Md. Akhtaruzzaman, Ph.D.
Director General, BIBM

Acknowledgement

The roundtable discussion titled **“**Safeguarding Trade Transactions and Prevention of Trade Based Money Laundering: Role of Correspondent Banks” comes to light with the immense support from many persons, especially from the executives of different banks to explore the concepts, status, and role of correspondent banking in Bangladesh. The study has also identified several challenges associated with effective implementation of correspondent banking relationships in cross-border transactions and made some recommendations. We would like to extend our gratitude to Dr. Md. Akhtaruzzaman, Honorable Director General of BIBM, for his valuable advice, observations, and thoughts to progress our research work.

The research team is indebted to the chief guest, panelists, and the participants of the roundtable for their valuable comments that immensely helped us to improve the quality of the paper. We are also very grateful to Dr. Ashraf Al Mamun, Associate Professor and Director (Research, Development & Consultancy) of BIBM for his support. We are thankful to Mr. Mohammad Habibur Rahman, EVP, Islami Bank Bangladesh Limited for his insightful thoughts in the study. The research teams expreeeses gratittue to the office of Research, Development & Consultancy, BIBM, to complete the publication process. Finally, we would like to thank all of those who extended their support in this research work.

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List of Abbreviation

ADs	Authorized Dealers
AML	Anti Money Laundering
AMLD	Anti Money Laundering Department
BAFT	Bankers Association for Finance and Trade
BAMLCO	Branch Anti Money Laundering Compliance Officer
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlement
BMPE	Black Market Peso Exchange
CAMLCO	Chief Anti Money Laundering Compliance Officer
CAMLCO	Chief Anti Money Laundering Compliance Officer
CBDDQ	Correspondent Banking Due Diligence Questionnaire
CBR	Combined Buffer Requirements
CDD	Customer Due Diligence
CFO	Chief Financial Officer
FCBs	Foreign Commercial Banks
CFT	Countering the Financing of Terrorism
CPMI	Committee on Payments and Market Infrastructures
ECC	Economic Consultative Committee
EEB	Emerging Entrepreneurs Business
FATF	Financial Action Task Force
FDBP	Foreign Documentary Bills Purchase
FE	Foreign Exchange
FEPD	Foreign Exchange Policy Department
FGD	Focus Group Discussion
FIs	Financial Institutions
FRSA	Financial Services Regulatory Authority
FSB	Financial Stability Board
GFET	Guidelines for Foreign Exchange Transactions
GFI	Global Financial Integrity
ICC	International Chamber of Commerce

FIUs	Financial Intelligence Units
IFC	International Finance Corporation
IFFs	Illicit Financial Flows
IVTS	Informal Value Transfer System
KYC	Know Your Customer
LC	Letter of Credit
LEI	Legal Entity Identifier
OCCRP	Organized Crime and Corruption Reporting Project
OFAC	Office of Foreign Asset Control
PCBs	Private Commercial Banks
RMA	Relationship Management Application
SBLC	Standby LC
SLR	Statutory Liquidity Ratio
BFIU	Bangladesh Financial Intelligence Units
SOCBs	State-Owned Commercial Banks
SoPs	Standard Operating Procedures
SWIFT	Society for Worldwide Interbank Financial Communication
TBML	Trade-Based Money Laundering
URC	Uniform Rules for Collection

Executive Summary

The regulators, banks, and financial institutions must comprehend the limitations of the present correspondent banking relationship due to the vital functions that these connections play. It is crucial while dealing trade-related compliance and regulatory needs as well as when handling TBML. Given the importance of correspondent banking, authorities throughout the world are interested in ensuring the secure and effective operation of these partnerships by managing any possible dangers.

The study discusses TBML risks connected with correspondent banking connections and lessons for the regulator and trade finance service providers in Bangladesh to protect trade and TBML initiatives. The paper's goals are to discuss correspondent banking risks associated with trade frauds, especially trade-based money laundering; understand risks and challenges associated with correspondent banking relationships in Bangladesh; and identify regulatory and operational stands for safeguarding trade and TBML through compliant correspondent banking relationships in Bangladesh.

The research is supported by both primary and secondary sources of data. The FATF (Financial Action Task Force), BCBS (Basel Committee on Banking Supervision), BIS (Bank for International Settlement), Wolfsburg Group, and IFC public sources were mostly used to create the global scenario. Through a questionnaire survey that included the trade services divisions and offices of CAMLCO of banks, primary data were gathered. 34 Private Commercial Banks (PCBs), 3 State-owned Commercial Banks (SOCBs), and 5 Foreign Commercial Banks (FCBs) together submitted 42 questionnaires. Additionally, two focus groups with representatives from the trade services division and offices of CAMLCO of banks were held. Thirty people in all participated in the FGDs.

There are four parts in the paper. After providing some background information and addressing objective and methodological difficulties in Section-1, Section-2 discusses conceptual and upsetting issues relating to correspondent banking relationships and TBML in a global environment. The consequences and

difficulties of dealing with TBML in the context of Bangladesh are discussed in Section-3 of this article. Section-4 also makes suggestions on how to protect Bangladesh's foreign commercial transactions by bringing up a few difficulties and associated banking relationships.

As of December 2022, banks had 20296 RMAs to facilitate cross border transactions. Half of the country's banks are having more than 350 RMAs, and there are also 22 percent banks have RMA of less than 150. To 60 percent banks, termination of correspondent banking relationships do not have significant impact. It might be true to some extent, however, it may also be interpreted as lack of awareness on the consequences of the termination of correspondent banking relationships with a section of banks. According to the survey observation, only about 20% banks are reviewing all RMA relationships on annual basis. However, about 30% banks are not reviewing RMA on annual and as and when required basis; approximately 50% banks are reviewing the RMA on sample basis not all RMA. Banks have identified some common challenges of reviewing RMA on regular basis. 85 percent banks have organized training sessions/events on the correspondent banking relationships.

Respondent banks globally use correspondent banking partnerships to seek business and grow their networks internationally despite rising risks, costs, and difficulties. Banks' operational independence is facilitated by direct access to important international markets, which enables them to offer consumers essential services. The following actions may help the correspondent banking relationship run well by managing TBML.

One, In general, significant correspondent banks (reputable multinationals) are subject to far greater scrutiny for their interactions with other parties, including international banks. The responding banks in Bangladesh need to be aware of the demands placed on correspondent banks by regulations, oversight, and enforcement. Different regulations, information requirements, format standards, and reporting methods may apply to each correspondent bank.

Two, Banks must have the right kind of perceptions, culture and processes for meeting compliance requirements for ensuring safe trade services and protecting interests of both clients and the country. Compliances should be perceived from both from technical and ethical perspectives. In the changing environment, compliance requirements is ever increasing and unpredictable. Respondent banks must be updated with the changing compliance expectations of the correspondent banks and regulators. Banks must ensure yearly reviews of RMAs for identifying risks and undertaking due measures to keep themselves away from the shell entities. International standards should mandatorily be followed by the banks of the country for handling correspondent banking relationships.

Three, Capable and skilled human resources are the key to handling difficulty and find future direction for efficient correspondent banking relationships. Banks need to invest heavily in capacity development of their employees to ensure better compliance and installing right processes and systems. Criminals have been consistently changing their strategy and using trade and banking channels for cleaning their proceeds and pursuing illegal fund transfer. Failure on the part of identifying TBML commonly causes termination of correspondent banking relationship and thus has notable implications for the efficient trade facilitation. Traders should also be brought under TBML and compliance related awareness events.

Four, Banks need to be aware of the one danger that the BFIU has highlighted. They claim that the SWIFT platform was used by all Shell banks, which were established in various countries, to transmit financial messages to other banks located anywhere in the globe. It must perform due diligence to determine whether the bank is subject to regulation by the Central Bank where it is registered before integrating with the SWIFT infrastructure. A technique for ensuring the shell bank's physical presence should be part of SWIFT. Evidently, SWIFT lacks such a mechanism. Additionally, the development of technology provides complete AML software that aids financial services in risk reduction and customer and account monitoring for shady activities. Through automated sanctions screening and identification verification, automation may help banks stay compliant.

Five, Important risk management measures include improved collaboration and communication. The nation's banks should have plans in place for cooperation, communication, and cooperative capacity-building and awareness-raising initiatives with their correspondent banks. As business and money laundering patterns change throughout the world, it is essential to maintain constant contact with authorities to understand their shifting expectations and compliance views. A better outcome on this front is anticipated as a result of the regulators' and trade finance institutions' collaborative capacity building initiatives.

Last but not least, it is generally known that the financing and trade payment methods employed in cross-border trade operations have an impact on TBML. From the perspective of TBML risks, using an open account and cash in advance is relatively dangerous. The country's substantial usage of LC and documentation gathering provides considerably superior protection through the banks' and regulators' considerable supervision over the transactions. Greater responsibilities and engagements in these strategies are played by correspondent banking relationships. It is important to keep in mind that risky correspondent banking connections not only negate the benefits of adopting these techniques but also open the door for TBML and illegal financial transfers through these channels.

Safeguarding Trade Transactions and Prevention of Trade Based Money Laundering: Role of Correspondent Banks

1. Introduction

Efficient and safe trade services are associated with the stability of the banking and financial industry, smooth cross-border trade transactions, and sustainable growth of an economy as well. Trade related malpractices, especially Trade-based Money Laundering (TBML) became a matter of concern for all global economies, and especially the issue became worrisome to the countries having the risks of illicit capital outflows through cross-border trade transactions. Financial sector regulators and trade finance banks/financial institutions have critical roles to play in combating TBML and trade service related crimes. Regulators see the issues from both macro and micro perspectives where protecting country's trade related interests and maintaining financial stability are areas of focus through ensuring compliance. Financial institutions/banks need to have a balance of their trade finance businesses and regulatory compliances that ultimately have implications for the safe and efficient cross-border trade transactions of an economy. In this process, correspondent banks have visible associations and correspondent banking relationships have notable significance and consequences.

Correspondent banks are commonly used by domestic banks to executive transactions, to get access to international markets, and to serve international clients without setting up branches. Payment facilitation, fund transfers, and trade facilitation are the most common goals of maintaining correspondent banking relationships[1]. Through correspondent banking

[1] According to the FATF glossary, "correspondent banking is the provision of banking services by one bank (the 'correspondent bank') to another bank (the 'respondent bank')". For the purpose of its guidance on correspondent banking (hereafter "the FATF guidance"), the FATF does not include one-off transactions but rather states that correspondent banking is characterized by its ongoing, repetitive nature. Like the FATF guidance, this Annex focuses on higher-risk correspondent banking relationships, especially cross-border correspondent banking.

relationships respondent banks (clients of the correspondent banks) also get ease in handling the challenges of external regulatory requirements. Thus, correspondent banking is a critical component of the global payment system, and for the emerging markets it works as a crucial channel to get access to the global network allowing international trade financing and efficient functioning of interconnected global financial systems.

Over the last few years, several negative perceptions came up regarding the correspondent banking relationship in response to the unearthing of a number of banking scandals where banks were found guilty of facilitating money laundering through their cross-border banking channel. Especially de-risking efforts on the part of some multinational banks in response to the regulatory penalty have drawn widespread attention from policymakers and stakeholders on the issues. It is now more or less recognized that the very nature of correspondent banking is conducive to trade finance fraud and malpractices. Correspondent banks have to rely on respondent banks' ability to monitor risks, and they must also be aware of the respondent banks' other correspondent banking affiliations; and respondent banks may also be affected due to the risks associated with the service facilitation process of the correspondent banks in different jurisdictions. It is practically limited information on correspondent banking activities that are exposed to money laundering and terrorist financing risks. Using 'shell banks'[2] in this process has made correspondent banking relationships complex and more concerning.

The crucial roles of the correspondent banking relationships necessitate understanding the limitation of the current correspondent banking relationship by the regulators, banks and financial institutions. It is particularly important in the context of handling trade related compliance and regulatory requirements and for handling of TBML. Considering the significance of correspondent banking, regulators throughout the globe

[2] A Shell Bank is a financial entity having no physical presence in any jurisdiction.

have interest to ensure safe and efficient functioning of correspondent banking relationships by handling any kind of potential threats.

The roundtable keynote is mainly about discussion on TBML risks associated with correspondent banking relationships and identifying lessons for the regulator and trade finance service providers in Bangladesh for safeguarding the country's trade and efforts on handling TBML. The specific objectives of the paper are: ***one,*** to discuss correspondent banking risks associated with trade frauds especially trade based money laundering; ***two,*** to understand risks and challenges associated with correspondent banking relationship in the context of Bangladesh; and ***three,*** to identify regulatory and operational stands for safeguarding trade and TBML through compliant correspondent banking relationship in the context of Bangladesh.

The study is based on both primary and secondary information. Global scenario was mainly drawn from the published sources of FATF (Financial Actioner Task Force), BCBS (Basel Committee on Banking Supervision), BIS (Bank for International Settlement), Wolfsburg Group, and IFC. Primary data were collected through questionnaire survey covering trade services departments and offices of CAMLCO of banks. A total number of 42 questionnaires were received from 34 Private Commercial Banks (PCBs) (Appendix-2), 03 State-owned Commercial Banks (SOCBs) (Appendix-2), and 05 Foreign Commercial Banks (FCBs) (Appendix-2), Moreover, two focus group discussions were conducted with the representatives from the trade services department and offices of CAMLCO of banks. A total number of 30 participants took part in the FGDs.

The paper is organized into four sections. Following a background, objective and methodological issues in Section-1, Section-2 is about conceptual and concerning issues of correspondent banking relationship and TBML in the global context. Section-3 is about the implications and challenges of correspondent banking relationships for handling TBML in the context of Bangladesh. And finally, Section-4 puts forward certain issues with recommendations regarding corresponding banking relationships for safeguarding Bangladesh’s international trade transactions.

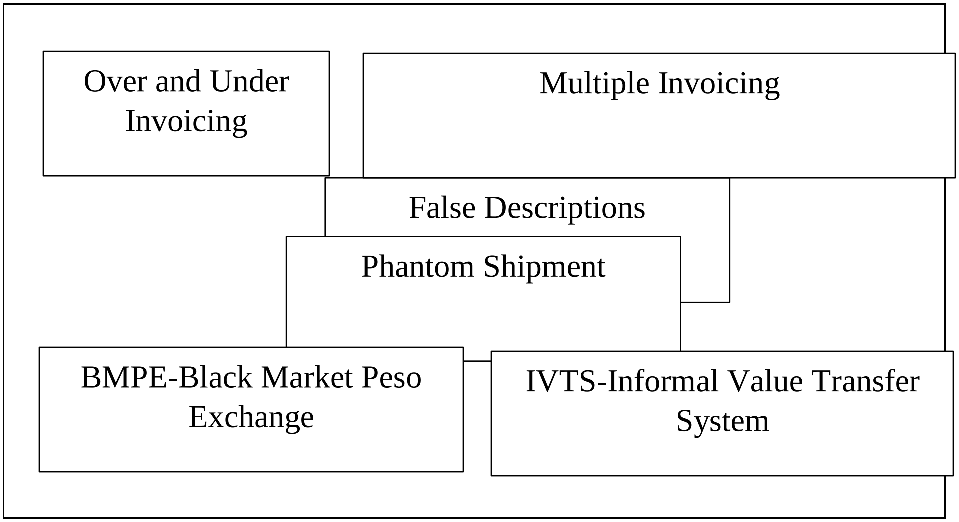
2. Trade Based Money Laundering and Correspondent Banking Relationship-Global Context

2.1 Trade-Based Money Laundering-Methods and Trends

Financial crime and trade related malpractice activities became increasingly complex in the increasingly interconnected global economy. And the most critical trade related challenge that came up as even as bigger challenge to both the regulators and the financial institutions is the TBML. Especially, the connection between global trade transactions and illicit financial flows is highly significant. TBML is said to be clearly associated with severe global criminal activities covering human, arms, and drug trafficking; trading of counterfeit goods, frauds and extortions; and cybercrime. TBML is taking place using both document-based and non-document based techniques. Trade misinvoicing is well recognized document-based method that alter price, quantity, quality or country of origin of a commodity or/and undervalue or over value exportable or importable or present falsified documents to illegally justify excess or less transfer of funds being transferred. Non-document based methods are challenging and tough to detect.

Over- and under-invoicing of goods and services to unlawfully transfer value across borders is the FATF's most prevalent TBML technique (FATF, 2020). Falsely characterizing items entails misrepresenting the quality or kind of goods or services to manipulate the transaction value, for as sending a high-grade good but putting a lower-quality product on the invoice and customs paperwork to cut taxes. A money launderer or terrorist financier might explain several payments for the same cargo or service by multiple invoicing. Phantom shipping or over/under shipment includes mismatching invoiced products with delivered goods (Figure-2.1).

Figure 2.1: Document-based and Non-Document Based Methods of TBML

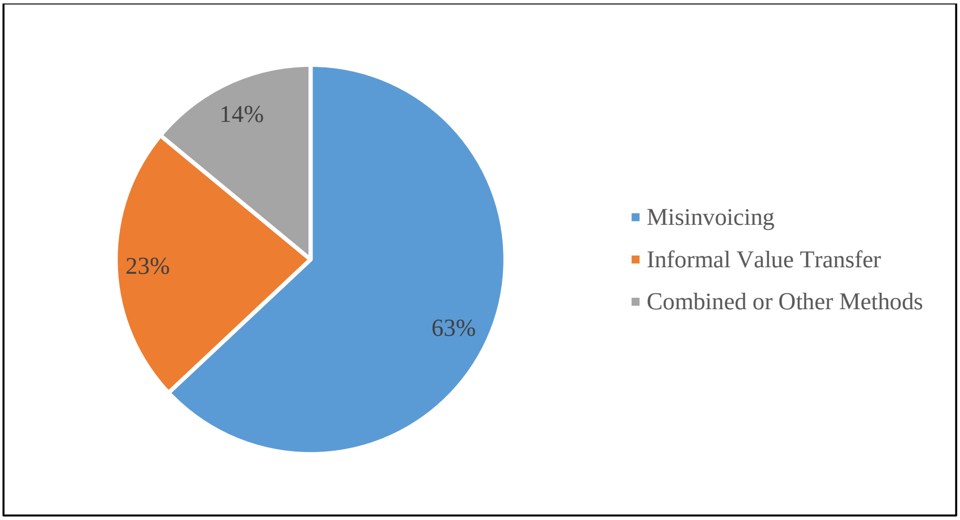


BMPE, or black market peso exchange, is a complex method used in narcotics-related TBML by criminal groups to move drug sales proceeds from the US (dollars) to drug producer countries (Latin America, pesos) without being caught. Drug traffickers use "peso brokers" to repatriate drug profits. Brokers buy cash from traffickers at a discount or for a fee. Then, "clean" money is utilized to buy legal items to export and sell in the drugs' originating nation. Since no money traverse international boundaries, law enforcement cannot discover BMPE (Yansura, et al., 2021).

IVTS, or Informal Value Transfer System, allows value to be transferred across countries without money being transferred. IVTS may be used to send cheap remittances or settle overseas accounts. A local representative arranges with a counterpart in another jurisdiction to pay a selected person the same amount. In "Hawala," IVTS is tied to trading. Due to their informality and lack of monitoring, they might increase TBML risk (FATF, 2020).

One of the most prevalent channels for IFFs is through the international trade system, and as of 2021, GFI estimates that the annual value of trade-related IFFs in and out of developing countries amounted to, on average, about 20 percent of the value of their total trade with advanced economies (GFI, 2021). And mis-invoicing (document based) is the most commonly used TBML techniques (Figure-2.2).

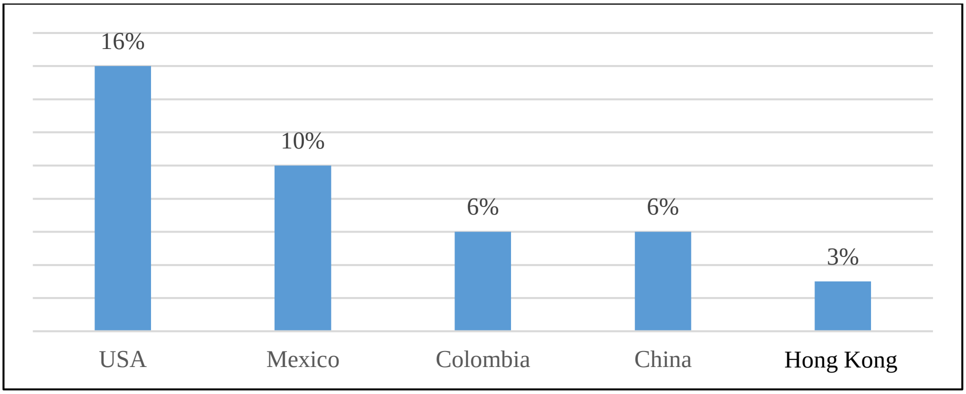
Figure 2.2: Techniques Used for Cleaning Proceeds



Source: Global Financial Integrity, 2023.

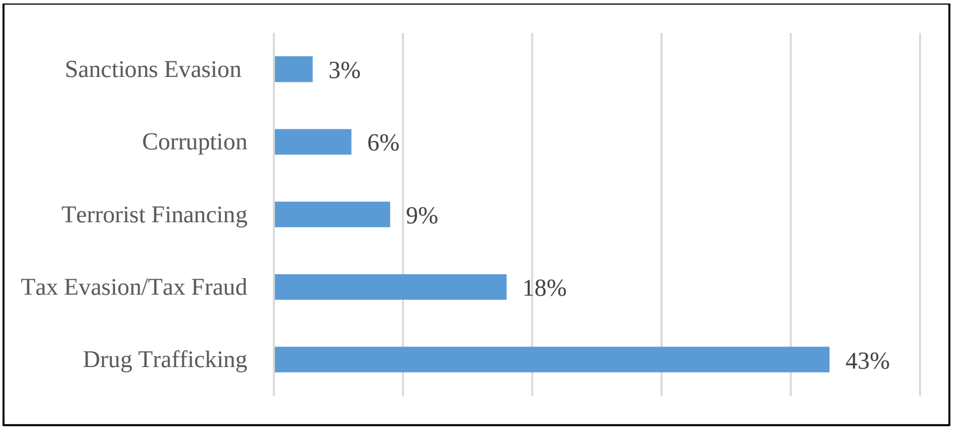
TBML cases are identified in 77 global economies as identified in GFI's most recent publication in January 2023. Most of the TBML cases are identified in USA followed by Mexico (Figures-2.3 and 2.4); and most of the proceeds are associated with drug trafficking (Figure-2.4). Identifying greater TBML cases does not always mean greater incidences of TBML, it also implies a country's capability to identify TMBL and other trade related crimes.

Figure 2.3: Jurisdictions with High TBML Cases [2011-2021]



Source: Global Financial Integrity, 2023

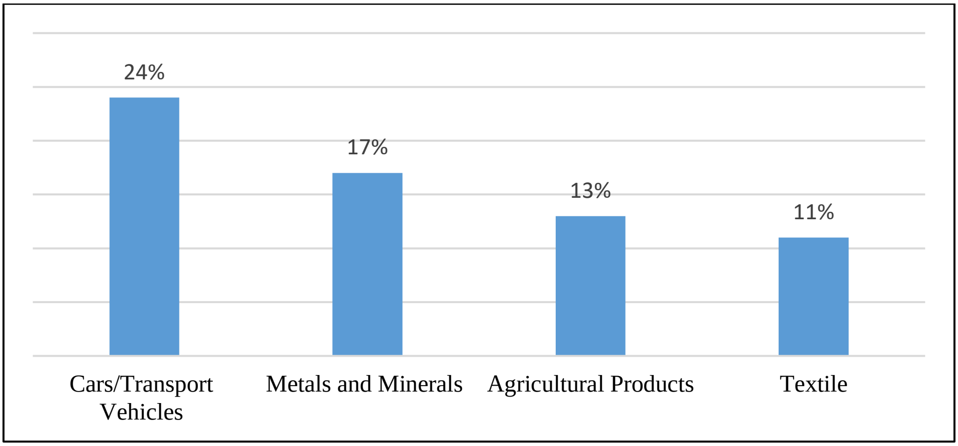
Figure 2.4: Criminal Activities for Cleaning Proceeds through TBML Techniques [2011-2021]



Source: Global Financial Integrity, 2023.

Illicit actors employ many items in TBML schemes, and any industry with AML loopholes is open to abuse. However, data suggests that some industries and goods are at danger. Cars/transportation, metals and minerals, agricultural goods, and textiles are the most prevalent TBML items (2011-2021) (Figure 2.5). A FATF research on TBML trends and advancements showed the same industries at high risk, with portable electronics included (FATF and Egmont group, 2020). Homeland Security Investigations (HSI) revealed that 70% of their TBML cases contain precious metals, autos, garments and textiles, and electronics (US-GAO, 2020).

Figure 2.5: Mechanizm Used in MTBL Schemes [2011-2021]



Source: Global Financial Integrity, 2023.

2.2 Changing Trends and Challenges of Correspondent Banking Relationship

Majority of cross border transactions are executed through correspondent banks, which in turn operate networks of bank relationships, which is the foundation of cross-border transactions to facilitate global trade, finance, and remittance (Rice, 2020). Access to foreign financial markets; extension of products and services; improved global reach; strengthening global trade and business; and compliance-driven regulatory safety are recognized benefits of correspondent banking relationships (Wolfsberg Group, 2022). And banks, as licensed and regulated entities, have emerged as trusted actors in ensuring the security of cross-border transactions through elaborate compliance-driven regulatory frameworks (Harper and Brodsky, 2023). World Bank (2015) study identified the decline in the correspondent banking relationships though the trend has not been uniform in all global economies. BIS data reveal, the number of active correspondent banks worldwide fell by about 3% in 2019 and about 22% between 2011 and 2019. And respondent banks, in particular smaller banks located in jurisdictions perceived to be very risky, are especially affected by the reduction in the number of relationships (CPMI, 2016). According to the correspondent banks interviewed for the CPMI (2015) report, the most common cause for this reduction of profitability of several banks was the increasing cost of regulatory compliance, especially in relation to AML/CFT regulation. And there are increasing trend in identifying TBML cases, greater compliance requirements, and over-consciousness on the part of banks in maintaining correspondent banking relationships.

The drivers for correspondent's de-risking can be categorized into two categories covering both financial risks and non-financial risks. Both categories have an impact on the costs for correspondents in maintaining relationships. Both of these have implications for maintaining and exiting correspondent banking relationship. Financial risk is associated with the creditworthiness of respondents and counterparts. Regarding Non-financial risks, the high cost of meeting compliance standards is one of the drivers in de-risking that commonly include AML/CFT, international sanctions, financial crime mitigation and client due diligence (CDD)/know your client (KYC). Compliance issues and periodical financial information requirements have increased remarkably in response to the de-risking efforts. However, CPMI (2016) observed, some correspondent banks are increasingly reluctant to provide correspondent banking services in certain foreign currencies in which the perceived risk of economic sanctions, the regulatory burden related to AML/CFT or the uncertainties related to the implementation of these requirements and the potential reputational risk in case of non-compliance seem to be higher.

The changing trends and challenges of correspondent banking relationships in the global context may be summarized as follows (Box-2.1) that have implications for both correspondent and respondent banks. Furthermore, the increasing gap in minimum requirements demanded by correspondents in terms of compliance (like Anti-money laundering, and Transaction Monitoring), when compared to the standards of respondents in emerging and developing economies, is a disincentive to building bilateral correspondent relations between global and regional banks. This results in regional banks only having access to the correspondent banking network indirectly through intermediaries (Alleyne, 2017).

Box 2.1: Key Trends and Challenges of Correspondent Banking Relationship

Reductions in the Number of Relationships	Increasing Cost of Maintaining Relationship	Over Conscious Approach & Reduction of Services
Differential Changes in Global Regions	Identification of Greater Number of ML/TBML Cases	Greater AML/TF and Compliance Requirements
Restricted Access to Certain Customers, Business Lines, Jurisdictions or Regions	Visible Implications of TBML Cases for Correspondent Banking Relationship	
Disincentive to Building Bilateral Correspondent Relations between Global and Regional Banks		

The changing situation and de-risking created space for new players to challenge correspondent banks' hold on cross-border transactions and cause correspondent banking to lose its role as the main method for cross-border transactions. According to CPMI (2020), trend showing increasing volume and value of USD transactions during 2011-2021, despite decreasing number of active correspondent banking relationships, suggesting concentration of flows. De-risking of respondents and conversely, the concentration of correspondent banking relationships may result in downstream correspondent banking or 'nesting'. Downstream correspondent banking is when a respondent bank extends correspondent banking services to other FIs, domiciled either locally in the respondent's country or abroad by leveraging its relationship with a correspondent. Downstream correspondent banking can be problematic for correspondent banks because it may obscure the parties of the transaction chain, increasing the potential AML/CFT, financial crime or sanctions risk (BCBS, 2016). In theory, correspondent banks are meant to run checks before taking new banks, known as 'respondent' banks, on board. But in reality, experts say, they often make insufficient inquiries into a respondent bank's history and client base. Respondent banks are sometimes acting as correspondent banks themselves, further obscuring the origin of suspicious funds. Known as "nesting," this practice can let less scrupulous banks access financial systems they otherwise couldn't. The correspondent banking system also spreads out accountability across multiple banks, making it harder to assign blame when dirty money enters the banking system. It raises concerns about the extent of monitoring high-risk countries, banks, and clients that must be enforced without disrupting cross-border trade and financial lifelines (OCCRP, 2022)[3]. Reduction of the provision of trade services due to de-risking may have notable implications. IFC (2017) notes, over 25 percent of 300-plus banks in over 90 emerging markets reported correspondent bank relationship losses. Beyond such losses, 72 percent of banks report that they face multiple exogenous challenges that reduce their provision of services that have implications for necessary imports for certain countries.

2.3 Correspondent Banking and Money Laundering through Cross-Border Trade

Money laundering through correspondent banking refers to the illicit process of disguising the origins of illegally obtained funds by utilizing the services and networks of correspondent banks. Criminals exploit the complexity and global reach of correspondent banking relationships to obscure the true source and ownership of illicit funds. According to

[3] https://www.occrp.org/en/troikalaundromat/faq-what-is-correspondent-banking

Marvellis and Ali (2023) money laundering can occur through correspondent banking in different ways (Box-2.2).

Box 2.2: Correspondent Banking and Money Laundering

Through layering criminals transfer money between accounts held at different correspondent banks or cross-border transactions, making it difficult to trace the original source of the funds.	Correspondent banks may unwittingly facilitate transactions **involving shell entities**, making it challenging to trace the true beneficiaries and ultimate purpose of the funds.
Inadequate due diligence practices by correspondent banks and inadequate risk assessment processes can allow illicit funds to flow through the correspondent banking network	Criminals may exploit **weaker AML controls in certain countries** to gain access to the international financial system through correspondent banks located there.

Note: Based on Marvellis and Ali, 2023

Following published cases (Mini Cases 2.1, 2.2, 2.3) are simply a glimpse of the enormous incidences of money laundering identified in different global economies that are facilitated through correspondent banking relationships.

Mini Case-2.1: Money Laundering Using Correspondent Banking Relationship

Turkish-Iranian money launderer helped Iran's sanctioned regime shift billions via correspondent banks from 2010 to 2015. Large banks handled USD6.5 billion for Zarrab-linked firms, investigators discovered. Correspondent banking may be used massively, as seen by Zarrab. The Turkish state-owned Halkbank allowed Zarrab to store Iranian oil money in accounts and send billions through Deutsche Bank, HSBC, Bank of America, JP Morgan Chase, Citibank, Standard Chartered, UBS, and Wells Fargo for years. These banks permitted transactions without much inspection since they have correspondent banking connections with Halkbank. Between 2010 and 2012, Latvia, a Baltic nation used to launder illegal assets from the former Soviet Union, sent USD20 billion a day into U.S. correspondent accounts, including billions in extremely suspect funds.

Note: based on https://www.occrp.org

Mini Case-2.2: Money Laundering Using Correspondent Banking Relationship

Between 2007 and 2015, Danske Bank Estonia facilitated USD236 billion in illegal activities. JP Morgan dissolved its partnership with Danske Bank in 2013, six years after the initial transactions. Deutsche Bank reduced their services by 60% to Danske Bank till 2015.

Source: https://elucidate.co/blog

Mini Case-2.3: Money Laundering Using Correspondent Banking Relationship

Mr X, a citizen of Country A, registered a bank in Country B ('Acme Bank'). Acme Bank was a shell bank, and had no real physical presence. Mr X deposited USD 25M of his money before moving on to Country C. In countries C, Mr X went to various banking institutions and, acting as a representative for Acme Bank, established correspondent banking accounts in the Bank's name. He then used the correspondent banking services of the host banks to transfer funds to Countries C from Acme Bank's accounts in Country B. Using this network of correspondent banking accounts Mr X was able to move money across jurisdictions, from where it was used for the purchase of high value and highly tradable goods.

Note: the example derives from a real case; slideplayer.com/slide/12856841/

Correspondent banking was at the center of the above mentioned money laundering cases that are attributed to several factors. Unfamiliarity with respondent bank's customers KYC is a central tenet of AML regulations, but correspondent banking services are at a clear disadvantage here. Moreover, growing number of non-traditional financial entities (that offer checking, savings and investment accounts) are clearing additional difficulties to get access to the right information. Efforts on the part of legitimate correspondent/respondent banks to fulfill AML regulatory compliances are commonly confronting several challenges: high cost, insufficient system, and challenge of verifying regulations across jurisdictions. [4]

Trade payments and financing techniques used in cross-border trade facilitation also involve different risks and regulatory issues that may be linked to the TBML. As methods of payment, cash in advance and open account are the simplest and cheapest, but they create the greatest possibility for opportunistic misconduct by trading partners. LC is the costliest form of trade payment method having significant involvement of correspondent banks. Documentary collection is cheaper than LC; however, sometimes it is risky for the exporter. In connection with some products, involvements of correspondent banks are significant (like LC) and thus regulator may have significant control to handle TBML and other trade related crimes. Regarding the ongoing approach of addressing trade based money launderers, Global Banking and Finance Review (2017) observed 'despite a significant proportion of international trade being conducted on 'open account' terms, firms' trade-based money laundering controls typically focus on transactions supported by traditional trade financing, such as Letters of Credit; and this is disproportionate and leaves a gap in the industry's response to TBML' (noted in Habib et al., 2018).

2.4 Guiding Framework for Correspondent Banking to Handle ML/TBML Risk

International bodies have proposed rules and strategies to address shifting correspondent banking needs and dangers. To avoid risks, responder banks and correspondent banks should have robust anti-money laundering and counter-terrorist financing compliance processes. Correspondent banking is

[4] https://www.jumio.com/correspondent-banking-aml

crucial for international business and transactions. To combat money laundering risks in correspondent banking, regulatory authorities and financial institutions must implement robust AML measures, including enhanced due diligence, transaction monitoring systems, information sharing, and compliance with FATF, BCBS, Wolfsberg Group, FSB, CPMI, IFC, and other international standards/guidelines. USA Patriot Act principles affect nations.

FATF advises risk-based correspondent banking arrangements to avoid money laundering. It urges increased scrutiny of cross-border correspondent banking arrangements. When establishing new correspondent financial connections, the correspondent organization might get the information from the responder. The FATF recommends discourse, communication, and risk-based approach upgrades for ongoing transaction monitoring and AML information exchange. In October 2016, FATF issued supplemental guidance specific to correspondent banking services, stating that combating financial crime should not raise trade barriers. Instead, the correspondent bank must regularly monitor the respondent bank's risk profile and take risk mitigation measures as needed, which aligns with FATF's risk-based approach to financial crime. According to FATF Recommendation 13, before establishing a new correspondent banking relationship, financial institutions should gather enough information about a respondent institution to fully understand its business, evaluate its AML/CFT controls, and get senior management approval, which is the true protection. Financial institutions cannot have correspondent banking relationships with shell banks.

The Basel Committee on Banking Supervision recommends senior management approval for a correspondent banking connection with a responding bank. The Basel Committee on Banking Supervision (BCBS) announced ML/FT risk management recommendations in June 2017, including an appendix on correspondent banking. The BCBS standards include FATF recommendations and the Committee's ML/FT risk management concepts to support FATF's aims. The Governors of the BIS Economic Consultative Committee (ECC) have mandated the CPMI to produce a report on this issue that identified guidelines on standardization of the minimum set of information; more effective KYC utilities; use of the Legal Entity Identifier (LEI) in correspondent banking.

The Wolfsberg Group, ICC, and BAFT have developed core principles, best practices, and other frameworks to help financial institutions manage financial crime risks globally. The 132-questionss of Correspondent Banking Due Diligence Questionnaire (CBDDQ) standardize minimal KYC information needs for respondent banks' onboarding and monitoring and reduces extra requirements. Wolfsberg Guidance on Society for Worldwide Interbank Financial Telecommunication (SWIFT), Relationship Management Application (RMA), and Due Diligence (2016) is also essential for correspondent banking relationships. The Guidance suggests handling non-customer RMAs. The organization recommends stringent RMA establishment and approval procedures to prevent financial crimes. According to FATF risk-based principles, RMAs should have minimal due diligence, continuous monitoring, and periodic reviews. Principle 5 of the Wolfsberg Anti-Money Laundering Principles for Correspondent prohibits correspondent banking clients from doing business with shell banks. Principle 7 prohibits institutions from selling to Shell Banks.

According to IFC (2018), correspondent banks typically examine the strength of AML/CFT regulations in the country where their respondent bank is based in due diligence, and respondent banks are expected to invest the resources needed to deliver information meeting global best practices of correspondent banks. To handle increased correspondent bank monitoring, high-risk respondent banks should have strong AML/CFT regimes. Correspondent banks use these country-specific assessments for CDD. IFC advised respondent banks to prepare for greater scrutiny from correspondent banks; evaluate the strength of their AML/CFT regime; train staff regularly on TBML detection, investigation, and escalation; exceed the minimum regulatory standards in combating TBML; establish well-defined operating procedures with FIUs on suspicious activity report delivery; and collaborate with other peer banks in the market to manage TBML risk.

In the US, sections 311 to 313 of the USA PATRIOT Act require US correspondent banks to conduct enhanced due diligence on respondent banks or terminate those relationships to address AML risks. Despite the increased dangers of correspondent relationships and the demands for additional due diligence, US authorities have provided guidelines stressing that due investigation should concentrate on respondent banks, not respondent bank customers.

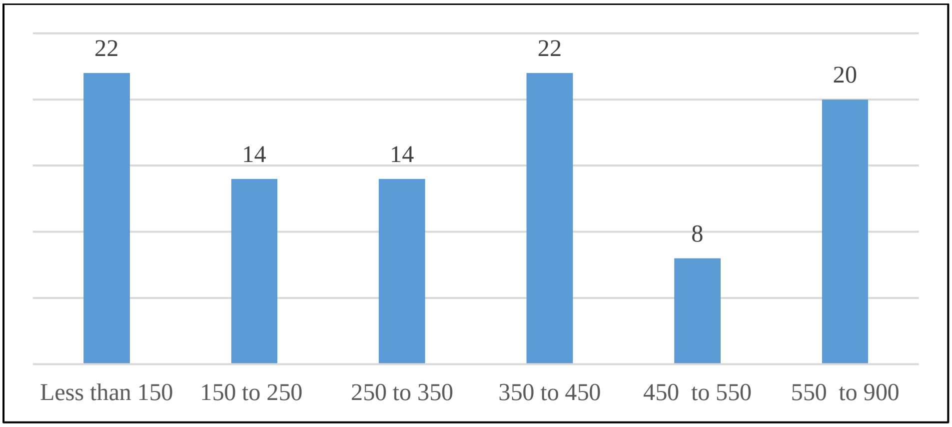
According to the above guidelines/recommendations, correspondent banks manage their relationships with respondent banks with two main goals: meeting specific regulatory obligations related to maintaining correspondent relationships, and meeting general compliance and supervisory obligations to report suspicious activity, prevent money laundering, and comply with economic sanctions. Thus, "know your customer" tests are not required. Correspondent and respondent banks should understand and record their AML or criminal compliance due diligence and information exchange requirements. After building its program, a responder bank must effectively, and often proactively, promote its strategy to the correspondent banks it wants to work with. Correspondent account access gives respondent banks freedom, stability, and strategic success. Respondent banks may insulate themselves from more scrutiny from correspondent banks. Respondent banks desiring long-term correspondent banking partnerships must build and maintain a competent AML or anti-crime compliance program (https://elucidate.co/blog).

3. Corresponding Banking Relationship and the TBML Risks: Bangladesh Context

3.1 Nature and Use of Correspondent Banking Relationship in Bangladesh

In the context of Bangladesh, trade services and remittance related activities like opening and maintaining accounts, exchanging authenticated SWIFT message, payment services and collections, granting credit lines, and foreign exchange market transactions. Commercial banks of the country have been offering relevant services using a good number of RMA. As of December 2022, banks had 20296 RMAs to facilitate cross border transactions. Half of the country's banks are having more than 350 RMAs, and there are also 22 percent banks have RMA of less than 150 (Figure-3.1).

Figure 3.1: Number of RMAs (in %) Maintained by Banks [as of December 31, 2022]



Source: BFIU, 2023

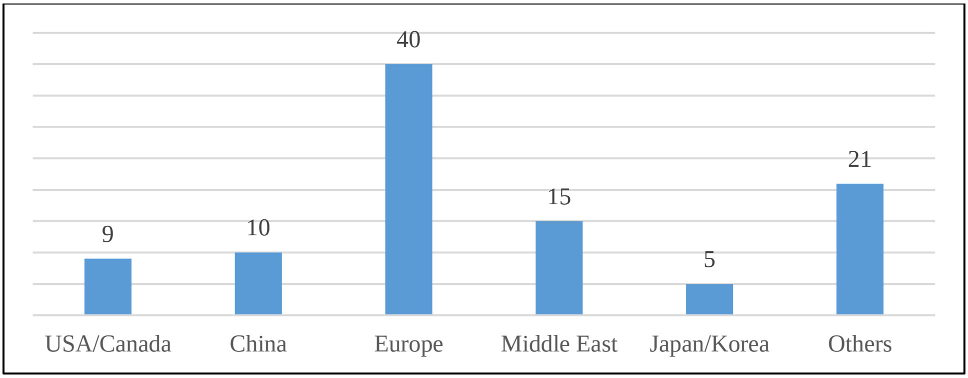
Banks generally follow an approval process for RMA. A very common approval process is briefly explained in figure 3.2. Banks follow circular /guidance notes of BFIU, requirement of correspondent banks, internal guidelines of respective banks in establishing RMA with foreign correspondent banks.

Figure 3.2: Approval Process of Selecting a Correspondent Bank

Approval Process	Collecting information about correspondent bank from various sources
	Seeking information from the correspondent bank
	Taking approval from top management and Compliance Unit
Documents Required	AML Questionnaire, Wolfsburg Group Questionnaire, Management and Shareholding structure, Financial Statements, Credit Rating, SWIFT KYC Register, Audited Financial Reports

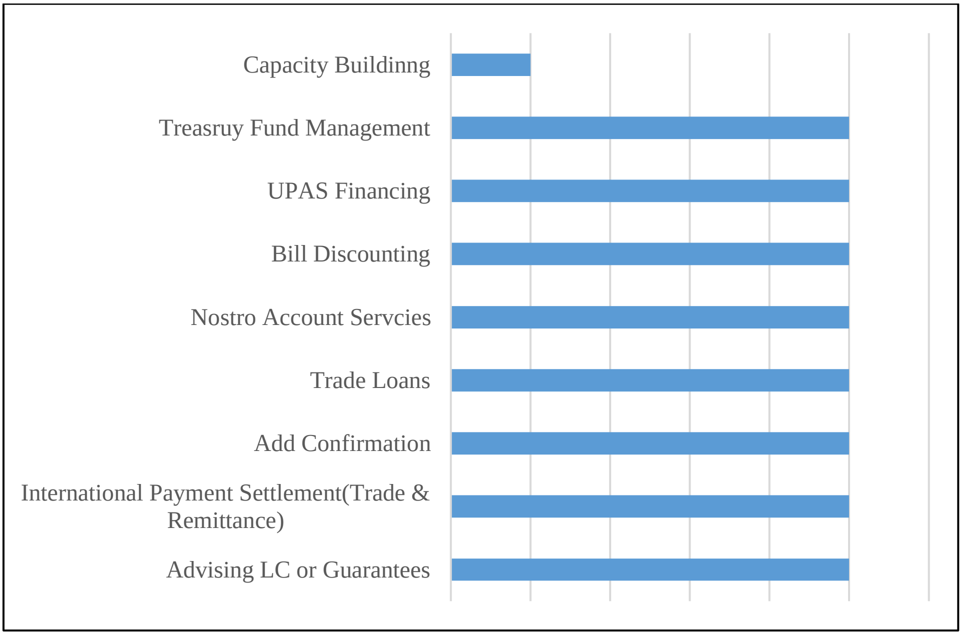
The other documents used in establishing RMA with banks are mainly USA Patriot Act Certification, W-8BEN-E, Sanctions Questionnaire, Passport/NID Copy of BoD and Senior Management, as found in the survey data. Geographical data indicate geographic locations of the correspondent banks, and thus implies distribution of correspondent banking networks (Figure-3.3).

Figure 3.3: Geographic Location of CBs



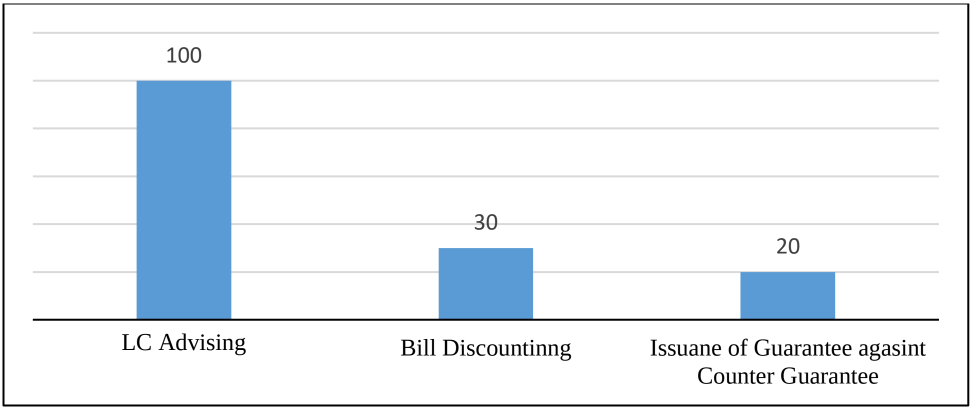
Source: Survey, 2023

Figure 3.4: Types of Services Obtained from Correspondent Banks



Source: Survey, 2023

Figure 3.5: Types of Services Provided to Correspondent Banks



Source: Survey, 2023

3.2 Domestic Regulatory Provisions for Correspondent Banking Relationship

In Bangladesh, to establish and maintain correspondent relationship, banks need to follow two folds of regulations; regulation (Box-3.1) circulated by Bangladesh Bank and BFIU[5] and regulation imposed by foreign correspondents/international standards[6].

Box 3.1: Responsibilities for Safe Correspondent Banking Relationships
To prevent money laundering and terrorist funding using Cross Border Correspondent Banking, follow these instructions: After gathering information about the correspondent or respondent bank, top management must approve correspondent banking service. Banks may only establish or maintain a correspondent banking connection with a foreign bank provided the appropriate regulatory body adequately supervises the correspondent or responding bank. No correspondent or respondent bank may establish or maintain a correspondent banking relationship with a shell bank. While establishing or maintaining a correspondent banking relationship with banks incorporated in a jurisdiction that does not meet or has significant deficiencies in complying with international money laundering and terrorist financing standards, banks must exercise Enhanced Due Diligence. Respondent bank customers using payable via accounts need CDD. Before establishing a correspondent banking relationship, the bank must get CAMLCO approval and guarantee the respondent or correspondent bank is regulated. **Source:** Summary from BFIU Circulars

Transactions using shell banks and handling of TBML drew special attention of the BFIU, thus a circular issued in June 2020 (BFIU Circular No-26) required approval of CAMLCO before establishing a correspondent banking arrangement. The bank must ensure that the respondent or correspondent bank is subject to proper regulatory oversight. No bank can establish or maintain a relationship with a shell bank. When maintaining or establishing CBR with banks situated in jurisdictions subject to increased monitoring and high-risk, the jurisdictions subject to a call for action as

[5] BFIU Circular No. 10, Date December, 2014; BFIU Circular No. 26, dated June 16, 2020; FE Circular No. 14 of March 29, 2021; FE Circular No. 25, Date: July 13, 2021.
[6] FATF, FATCA, Wolfsberg Principle Checklist, Correspondent Bank's Own Policy for AML, etc.

published by FATF where banks are required to adhere to the EDD process. The circular has also provided a questionnaire relating to establish or maintain a correspondent banking relationship to prevent money laundering and combat the financing of terrorism.

Certain cross-border trade transactions related circulars (FE Circular No. 25, dated July 13, 2021; FE Circular No. 12, dated March 19, 2020; FE Circular No. 14, dated March 29, 2021) referred BFIU circulars and called for special attention in facilitating trade services through correspondent banking relationships and transactions with shell banks with the same goal of handing TBML risks (Box-3.2).

Box 3.2: Regulatory Provisions for Handling TBML Risks Facilitated through Correspondent Banking Relationship

AML/CFT compliance for correspondent relationships, nostro accounts, and transactions. Foreign Exchange Risk Management's instructions to maintain cross-border correspondent banking relationships include observing applicable extended due diligence and restricting correspondent relationships with shell banks.

-ADs must take precautions before doing export trade: ADs must verify the bonafides of applicant banks/issuing banks in cases of LCs received through authenticated channels from third banks to facilitate export transactions under LCs. ADs must guarantee that application banks/issuing banks get export papers directly from them or via third banks/other authenticated banks with whom they have suitable relationships. ADs must verify the initial beneficiary, transferring bank, and LC applicant/issuing banks for transferred LCs.

- ADs shall satisfy bonafide of importers abroad as per GFET, and shall conduct due diligence on importers' banks designated for transactions under sales contracts to ensure their step-by-step responsibilities regarding release of export documents by designated banks to importers and procedural arrangement of payment as per GFET, its subsequent circulars, and relevant provisions of the Uniform Rules for Collection (URC) in force. ADs must guarantee that importer's banks get export papers directly from them or via third banks/other authenticated institutions with whom they have proper relationships.

-ADs shall guide exporters to change designated banks of importers acceptable to ADs, bring the transactions under external payment guarantees as per FE Circular No. 25 of

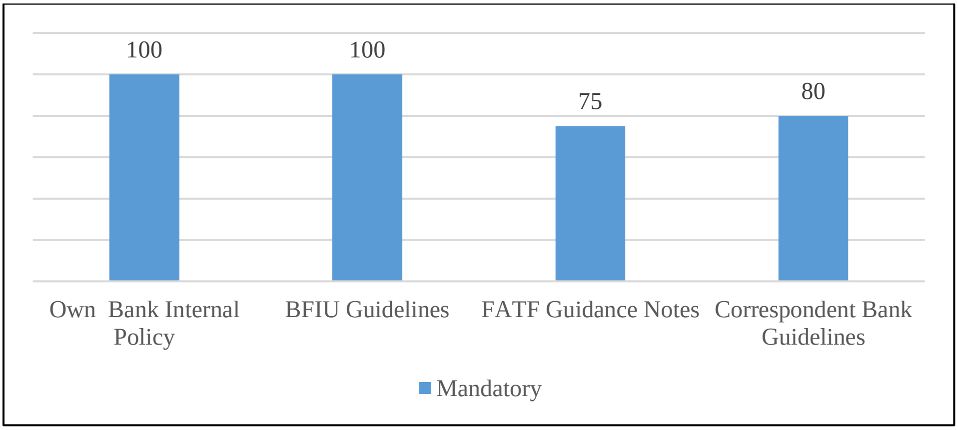
June 30, 2020, and make other suitable arrangements if there are any difficulties or doubts about the transactions.

BFIU's Infrastructure Level Risk Assessment of Guidelines for Prevention of TBML recommends vessel tracking systems for ADs. ADs must trace all shipments using a competent authority-approved tracking system to protect export transactions.

Source: Summary from FE Circulars

In the process of correspondent banking relationship, all banks commonly have their internal mandatory policy/guidelines, and also banks are required to follow certain guidelines issued by BFIU/FE. However, not all banks mandatorily follow guidelines issued by the international agencies (like FATF, Wolfsberg Group, etc.) or correspondent banks (Figure-3.6).

Figure 3.6: Guidelines Followed by the Banks in the Process of Maintaining Correspondent Banking Relationship

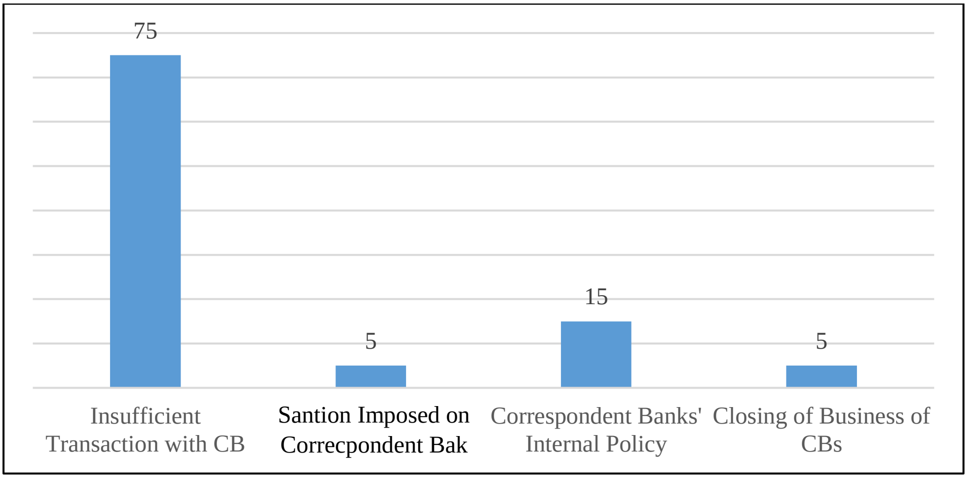


Source: Survey, 2023

3.3 De-risking and Correspondent Banking Relationship in Bangladesh

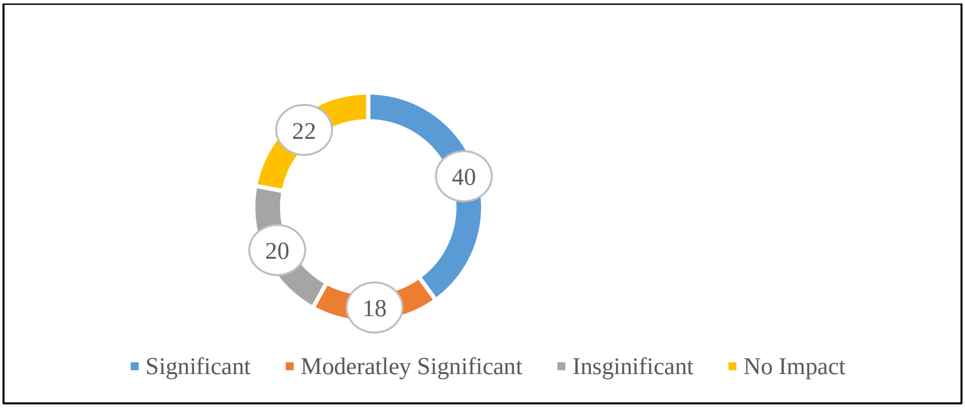
As part of de-risking several local banks were affected since then due diligence became challenging in the process of maintaining correspondent banking relationship. Globally, most of the banks that terminated nostro accounts or correspondent banking relationships are from USA and Europe. According to a survey (Habib et al., 2018), of the banks around 53 percent faced correspondent relationship termination from USA. Today following local laws, international standards and USA laws became almost a recognized standard for effective correspondent banking relationship throughout the globe including Bangladesh. The reality is, most multinational banks are not providing correspondent banking services to any new banks rather keep on reviewing existing relationships with a number of banks in Bangladesh. Despite all these challenges, businesses and volume of transactions remained the key driver for correspondent banking relationship (Figure-3.7). To 60 percent banks, termination of correspondent banking relationships do not have significant impact. It might be true to some extent, however, it may also be interpreted as lack of awareness on the consequences of the termination of correspondent banking relationships with a section of banks (Figure-3.8).

Figure 3.7: Reasons for Termination of Correspondent Banking Relationship



Source: Survey, 2023

Figure: 3.8 Impact on Banker Customer Relationship due to the Termination of CBR



Source: Survey, 2023

3.4 Risks and Concerns Associated with Transactions through Shell Banks and Suspicious Trade Transactions

Transactions through shell banks drew special attention of BFIU. So far Bangladesh FIU has detected 12 Shell Banks. Most of the Shell Banks are registered in the Tax Heaven Jurisdiction especially in the Caribbean Islands. At the time of registration, these shell banks use the term "Bank" as a suffix in their name. These types of Banks do not disclose income statements, Audited Balance Sheet, Annual Reports, Capital Structure, Ownership Structure, Management information on its website. Reputed credit rating agency shows it does not have any capital or adequate capital for Banking Business. Though it is registered in tax heaven jurisdiction, but it does not have any physical presence in the country where they are registered. It is often used USA or UK based address as its representative/business address to make more credible to foreign financial institutions. The techniques/steps that are commonly followed in facilitating transactions through shell banks may be summarized in Box-3.3.

Box 3.3: Common Steps of Transactions through Shell Banks in Bangladesh

-After getting registration, Shell Banks can use SWIFT Platform to exchange secured Banking communication with any other Banks of the World.

- Shell Banks send proposal for RMA to Bangladeshi Banks. RMA is a SWIFT Mandate authorization which enables FIs to exchange FIN messages. For more reliability, some Shell Banks also manage to achieve Banker's almanac membership where any member Bank able to get KYC related information from other Banks.

-Some of the less aware banks fall into the trap and establish RMA with the Shell Banks. Consequently, Shell Banks sent hundreds of LCs in favor of Bangladeshi Banks; and after receiving the LCs through SWIFT Channel, Banks forwarded these LCs to the Bangladeshi Exporters as mentioned in the LC clauses.

-Suppliers/Bangladeshi Exporters do not have idea about the Shell Banks/foreign FIs. As per terms and conditions of LC Bangladeshi supplier prepare the products, complete all the formalities including Customs formalities as per local rules and make shipment from Bangladeshi Port to the destination port through any international vessel.

-As per Bangladeshi Law, Export Proceeds must be repatriated to Bangladesh within 120 days from the date of shipment. After the export performance, suppliers of Bangladesh may sell the export bills to the LC receiving bank. If documents are in complying presentation (as per terms and condition of the LC), Banks may purchase the documents at a discount rate and pay export value to the supplier's account.

-After 120 days, the importer's bank (Shell Bank) does not pay any single penny to the exporter's Bank i.e., Bangladeshi Banks. Within the time frame of 120 days the foreign Shell Banks were able to send hundreds of LCs in favor of Bangladesh Banks. When the payment obligation comes, usually the Shell Banks do not respond to payment request or disappear from everywhere even from the virtual/websites.

Note: Based on Information from BFIU

BFIU also reveals that importers of some countries are also Shell Companies. Credit report of the importers (Buyers) also shows that these companies are offshore nature that does not have physical presence or use another company's address as its address. Credit rating companies are unable to disclose the ownership structure as well as financial information. Several shell banks follow unique approach to get access to RMA with banks. Authentic information might be helpful to identify shell banks (Mini Case-3.1).

Mini Case 3.1: Shell Banks' Approach and Authentic Information to Identify Shell Banks

Euro Exim Bank Ltd. (EEB), incorporated, authorized, supervised, and regulated by the Financial Services Regulatory Authority (FRSA) in St. Lucia, West Indies sent a request to one of private commercial banks in Bangladesh for establishing correspondent relationship with EEB. Having the request of EEB, international division of the bank sought approval or advice from Anti Money Laundering Department of the local private commercial bank whether they should enter into any relationship with that bank. AMLD searched for information regarding the entity in the market (other banks, online search, etc.) and got feedback that it was not a full-fledged bank; a "shell bank" indeed. However, their address was found on the webpage of FSRA, St. Lucia (www.fsrastlucia.org) and was written against a Post Office Box, in Google Maps, no specific building was shown. Finally, AMLD advised not to go for business relationships with entities situated in the West Indian countries. In some cases, it was found that Shell Banks recruit local representatives to build up confidence on establishing RMA. Shell Banks also target new banks and other banks that are trying to expand trade finance activities.

Source: Case Study based on the discussion with the Bank Executives

In several instances, banks have purchased/discounted the export/Foreign Documentary Bills, exporters some time feel no urge to repatriate the export proceeds. During 2017 to 2020 (before COVID-19 Pandemic), products valuing around USD 1.6 billion was exported from Bangladesh through the above-mentioned "Shell Banks Trap" through international trade. It was also observed that the unit price mention in the LC was competitive, goods were shipped in proper channel, and all the documents were authentic except the LC issuing banks and importers. This became another avenue of TBML where Bangladesh might suffer.

As actions, BFIU penalized all the banks who had established RMA with Shell Banks as well as the banks that failed to conduct CDD procedure after receiving LC from Shell Banks. BFIU shared this typology with all the commercial banks and instructed all the banks in Bangladesh to review all the RMA and close the relationship immediately with the Shell Banks. Bangladeshi banks have already reviewed and closed relationships with a significant number of Shell Banks. BFIU has also requested SWIFT not to provide connectivity or membership of Shell Banks.

In several instances, banks in Bangladesh and clients were affected due to the use of shell banks or execute TBML/suspicious transactions through using correspondent banking relationships (Mini Cases-3.1, 3.3, 3.3). Sometimes penalties imposed on a correspondent bank caused harm to the local respondent banks (Mini Case-3.2). These cases offer invaluable lessons to the banks and traders on the risks of using less reputed/unknown correspondent banks or correspondent banks in certain risky jurisdictions. Certain nature/types of cases are also red flags for the respondent banks of the country (Mini Cases-3.4 and 3.5).

Mini Case 3.2: Bangladeshi Banks Affected by the Fine Imposed on Overseas Correspondent Bank

Permanent Subcommittee of Investigation (PSI), a subcommittee of US Senate has investigated X Bank, a UK origin correspondent banking service provider operating in the USA and many other international locations. The investigation was conducted how X Bank was serving as a middleman for Mexican drug cartels and facilitating money laundering through its international networks. After four year's investigation, PSI has released the investigation report and X Bank was fined by the US Federal Regulators for USD 1.90 Billion. Two Bangladeshi banks were mentioned in that report as a respondent Bank of X Bank. Upon publishing the report, a number of correspondent banks have terminated, frozen or limited the correspondent banking relationship with two mentioned Bangladeshi banks.

Note: Bank Source

Mini Case 3.3: Trade Based Money Laundering through Offshore Banking Operation Using a Valid Correspondent Banking Network

PTFCL, a Singaporean fundraising company, asks X Bank in Bangladesh for a $20 million loan. The PTFCL's Singapore license was revoked, making it a sham. PTFCL applies for a loan from X Bank in Bangladesh with the bank's key officers and Board members. PTFCL applied without registration documentation. On behalf of PTFCL, Canadian director Mr. A signed the loan application. X Bank invested USD 20 million at 8% with PTFCL. PTFCL committed to invest USD 80 million with the Bank within 95 days after receiving loan USD 20 million. PTFCL establishes Dubai-based "Ching General LLC" as an SPV to transfer borrowed monies. SPVs had to be financial institutions or investment companies, but they traded. "Ching General LLC" opens an account with Bank Y, X Bank's correspondent banking partner in the UAE. The loan arrangement required PTFCL and X Bank to jointly handle the Y Bank account. It didn't. The Chairman of X Bank was the nominee of the USD 20 million fund and a joint signatory of the Dubai account with Y Bank. Finally, X Bank sends Y Bank USD 20 million. The money was lost afterwards. Since X Bank had no foreign currency, it bought USD using BDT from the Dhaka Interbank Money Market at a higher price. Ching General LLC cancelled its Y Bank account and withdrew the whole money after remitting it.

Note: Bank Source

Mini Case 3.4: Crescent Leather Case Relating to Correspondent Banks

A large private commercial bank provided Crescent Leather, an export-oriented firm, project finance of BDT 5000 Crore. The firm was mainly involved in manufacturing and exporting leather wallets, belts, Shoes and leather Bags. In their official website prices of each products are clearly mentioned. But the export value of each items were 4 to 5 times higher than the published rates. Crescent leather received 653 export LCs valuing BDT 1309 Crore in the last quarter of 2019 from the different companies of USA, UK and 8 different companies of Hongkong. Moreover, the same bank issued hundreds of LCs in favour of Crescent Leather in past LCs. 60% of the buyers were from Hongkong with same address in Kowloon, Hongkong. With further investigation, it was found that buyer’s office was tiny (200 square feet room) and owners of the 8 companies are mostly Bangladeshi. In all the export LCs, the name of issuing bank was a commercial bank incorporated in Gambia. The issuing bank was licensed by the Central Bank of Gambia. All the export proceeds were transferred from different banks in Dubai and Singapore using MT 202 SWIFT. The export payment banks in Singapore did not ask the Ordering Customers/senders why they are sending money to a Bangladeshi Banks mentioning EXP/FDBP as reference. Here the foreign correspondence banks are also used as a vehicle for TBML. Products were exported to

EU and USA. But no export proceeds were repatriated from the LC issuing Bank or from the importing countries. Moreover, in 5 calendar years (2015-2019), the leather company received BDT 1171 crore as cash incentives (Export Subsidy). As per FEPD Circular: Leather Products are eligible for 15% cash incentives with some condition for repatriation.

Note: Bank Source

Mini Case 3.2: MT 710: Advice of a Third Bank's or a Non-Bank's Documentary Credit: Facilitates Trade with Hidden Compliance Concern

Documentary credits are predominantly transmitted through MT700 SWIFT messaging, where the sender is the issuing bank of the credit, and the receiver is the proposed advising bank. Both the sender and receiver have active RMA relationships. However, Documentary credits are sometimes transmitted through MT710 SWIFT messaging, whereas the sender is not the issuing bank of the credit but maintains active RMA relationships with the receiver. The issuing bank of the credit is mentioned inside the credit condition, particularly in field 52a. Typically MT710 is utilized where the issuing bank is a bank or non-bank having no RMA relationship with any bank in the beneficiary's country. Under these circumstances, As the receiver of the Documentary credit advises the credit to the beneficiary adhering to UCP 600 and compliance laws and regulations, the exporter's bank (usually a nominated bank) may fall into the trap that the bank may be "Shell Bank or high-risk bank to facilitate the transaction. Bank should have an internal policy regarding handling documentary credit through MT 710.

Note: Bank Source

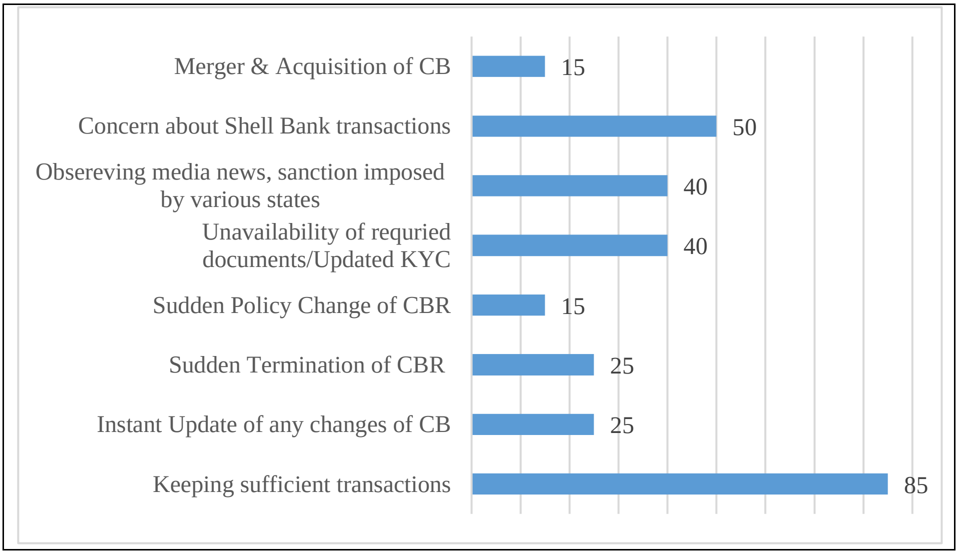
Mini Case 3.3 : Standby LC or Guarantee Coverage Loan: A Possible Money Laudering Technique

The market has observed that existing or prospective customers approach banks to extend credit facilities in local currency fully covered by Standby LC (SBLC) or Demand Guarantee from abroad. This trend is suitable and very much practiced where the sister concern operates in Bangladesh and has no or inadequate security for credit facilities. The parent company arranges a repayment guarantee from a foreign bank in the form of SBLC or a guarantee to extend credit facilities favoring sister company. However, local companies approach banks to extend credit facilities to them against SBLC or Guarantees issued by foreign banks. In most cases, there is no business relationship between the applicant of the SBLC or guarantee and the customer and no reasonable basis for issuance of the SBLC or guarantee to extend the credit facility to the customer. One potential concern may be that extended credit facilities might be settled through a claim under SBLC or demand guarantee when turned into classified loans. The repayment may be derived from money laundering abroad and entering Bangladesh's Economy. Correspondent Banking relationships are the weakest link to facilitate this type of transaction.

Note: Bank Source

Banks identified several challenges/concerns in the process of maintaining correspondent banking relationships. Keeping sufficient transactions and concerns about shell banks are identified as the most common challenges by the representatives of trade services departments and the offices of CAMLCO of banks of the country (Figure-3.9).

Figure 3.9: Challenges Faced by Respondent Banks in Maintaining CBR



3.5 Risk Management Efforts on the Part of Banks

Regular review of RMA is a recognized risk management associated with correspondent banking relationships. It has become best practice across the global banking industry to review all the correspondent banking relationship once every year unless there is no significant change in the board, senior management or change to legal, regulatory or supervisory requirement of the counterparty banks. Common issues that are considered in the RMA review process are as follows:

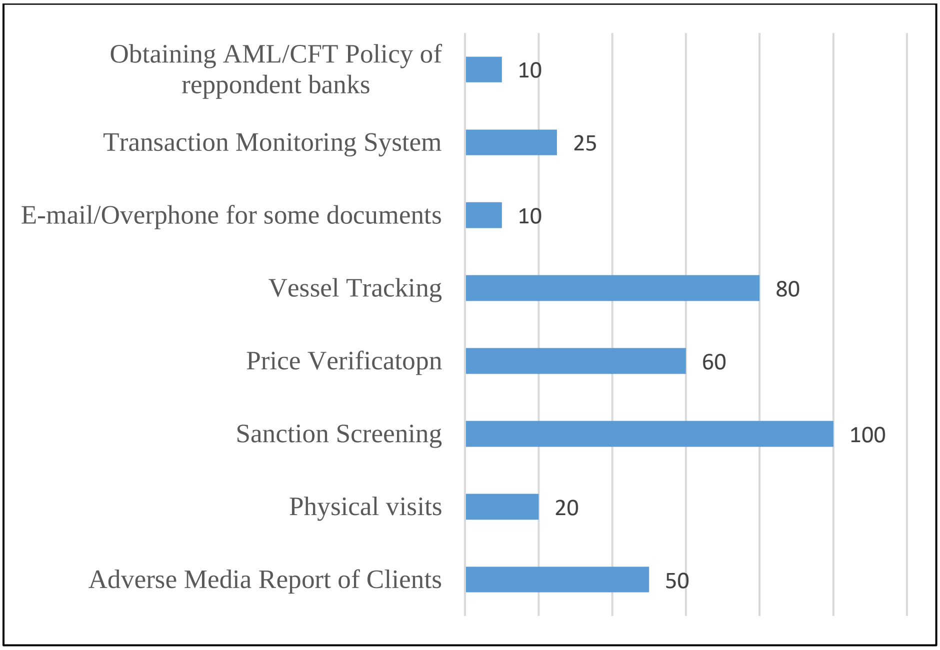
Box 3.4: Issues are Considered in Reviewing RMA
• Updated licenses and certifications • Board of Directors and senior management whether there is any PEP • involvement, adverse media or sanctions • Any business link with Shell Bank • Downstream or nested correspondent services • Any fine or regulatory countermeasures imposed on counterparty banks • Business segments i.e. percentage of deposit, loans and advances in different • sectors and industries • Adequacy of AML, ABC and sanctions compliance program • Policy, process and control mechanism of compliance functions of the Bank. **Source:** Survey/FGD, 2023

According to the survey observation, only about 20% banks are reviewing all RMA relationships on annual basis. However, about 30% banks are not reviewing RMA on annual and as and when required basis; approximately 50% banks are reviewing the RMA on sample basis not all RMA. Banks have identified some common challenges of reviewing RMA on regular basis (Box-3.5).

Box 3.5: Challenges in reviewing the RMA
• Banks have no adequate manpower to review all the RMA relationships every year • Banks have no SoPs (Standard Operating Procedures) to review the RMA • Banks have no sufficient trained and professional staff to review the RMA • Counterparty banks are not cooperating by providing all required documents to complete the review process • Automated and technology-based system generated tools are not available in the banks to conduct the review process • There is no regulatory enforcement action for non-reviewing RMA. **Source:** Survey/FGD, 2023

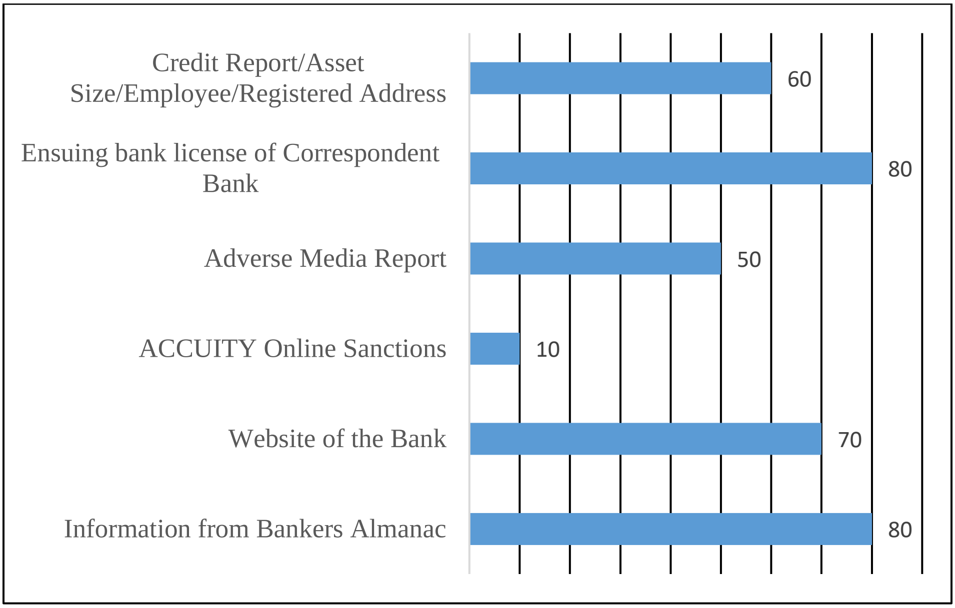
Banks in Bangladesh follow some common approach to minimize risks associated with correspondent banking relationships (figure 3.10), and to avoid or identify shell banks (3.11), as claimed in the survey. Sanction screening claimed to be the most common. It is well recognized that adequate training and awareness events are crucial risk management tools. 85 percent banks have organized training sessions/events on the correspondent banking relationships (Figure-3.12).

Figure 3.10: Measures to Handle Risks associated with Correspondent banking Relationship



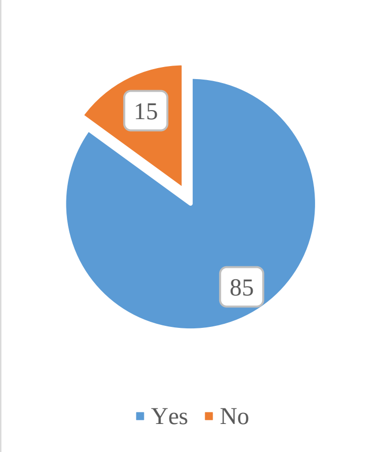
Note: Survey, 2023

Figure 3.11: Measures to Avoid Shell Banks



It is well recognized that adequate training and awareness events are crucial risk management tools. 85 percent banks have organized training sessions/events on the correspondent banking relationships. However, there are huge scopes to improve training programs in the duration, frequency and contents (Figure-3.12). The contents covere+d in the training mainly include understanding process and risks associated with correspondent banking, Wolfsburg Questionnaire, Shell bank and beneficial owner. Sanction screening and impact of noncompliance in trade transactions, money laundering through correspondent banking relationships and risk-based approach for establishing new and reviewing existing correspondent banking relationships are also discussed in the training. In some cases, training related to correspondent banking is integrated with AML and CFT training programs. Some banks also have developed E-Learning platform for all employees of those banks.

Figure 3.12: Training on CBRs, Duration and Frequency



Duration	• 2 hours (10%) • 1-day long training (50%), • 2-day training (20%) • Others 40%
Frequency	• Monthly (10%), • Quarterly (20%), • Half yearly (5%), • Annually (20%) • Once in every two year (10%)

Note: Survey, 2023

4. Suggested Policy and Operational Approach to Correspondent Banking Relationship for Handling TBML and Safe Trade Service Operations in Bangladesh

Despite growing risks, costs, and complexities, respondent banks worldwide value correspondent banking relationships to pursue business and expand global networks. Direct access to major global markets facilitates banks' operational independence and allows them to provide critical services to customers. Following steps might contribute to the efficient correspondent banking relationship through handling TBML.

One, Generally, major correspondent banks (reputed multinationals) are facing much higher scrutiny for the relationships they have with global bank and others. Bangladesh's respondent banks must understand the regulatory, supervisory, and enforcement pressures on correspondent banks. Each correspondent bank may have differences in policies, information requirements, formats, reporting procedures. It has become necessary to be prepared for greater scrutiny from your correspondent banks over your bank's capacity to deal with TBML risks, and invest in the necessary resources to respond with adequate information. It is important to thoroughly ‘know your customer’s at all times. As respondent banks, banks of the country should evaluate their capacity in this regard on regular basis.

Two, Banks must have the right kind of perceptions, culture and processes for meeting compliance requirements for ensuring safe trade services and protecting interests of both clients and the country. Compliances should be perceived from both from technical and ethical perspectives. In the changing environment, compliance requirements is ever increasing and unpredictable. Respondent banks must be updated with the changing compliance expectations of the correspondent banks and regulators. Banks must ensure yearly reviews of RMAs for identifying risks and undertaking due measures to keep themselves away from the shell entities. International standards should mandatorily be followed by the banks of the country for handling correspondent banking relationships.

Three, Capable and skilled human resources are the key to handling difficulty and find future direction for efficient correspondent banking relationships. Banks need to invest heavily in capacity development of their employees to ensure better compliance and installing right processes and systems. Criminals have been consistently changing their strategy and using trade and banking channels for cleaning their proceeds and pursuing illegal fund transfer. Failure on the part of identifying TBML commonly causes termination of correspondent banking relationship and thus has notable implications for the efficient trade facilitation. Traders should also be brought under TBML and compliance related awareness events.

Four, Banks must be aware of the one risk identified by the BFIU. According to them, Bangladeshi banks have experienced that all the Shell banks which originated from different jurisdictions got the SWIFT platform to send the Financial message to other banks of any part of the world. Before onboarding the SWIFT platform, it has to conduct due diligence whether the bank is regulated by the Central Bank where it is registered. SWIFT should have a mechanism to ensure physical presence of the shell bank. Apparently, SWIFT does not have such a mechanism. Moreover,technology adoption offers comprehensive AML software that helps financial services enhance risk mitigation and monitor customers and accounts for suspicious activity. Automation can help banks stay compliant through automated sanctions screening, identity verification and AML transaction monitoring that ensure compliance while streamlining time investment and reducing costs. Investment in technology and automation is the need of the time for coming up with the level of expectations of clients, regulators, and correspondent banks.

Five, Greater communication and coordination are crucial risk management tools. Banks of the country should have arrangements for communication and coordination, and arranging joint capacity development and awareness efforts with their correspondent banks. Continuous communications with regulators are crucial to understanding their changing expectations and compliance perceptions that are consistently changing with the changing business and money laundering trends throughout the globe. Joint capacity development efforts of the trade finance banks and the regulators are expected to bring better outcome on this front.

Finally, it is well recognized that trade payments and financing techniques used in cross-border trade transactions have implications for TBML. Using open account and cash in advance is relatively risky from the point of TBML risks. Extensive use of LC and documentary collection in the country offer relatively better protection in the form of extensive control over the transactions by the banks and regulators. Correspondent banking relationships have greater roles and engagements in these methods. It is to be remembered that risk prone correspondent banking relationships not only destroy the advantage of using these methods but also facilitate illicit fund flows and TBML through correspondent banking channels.

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Appendix 1: Questionnaires for Banks

Bangladesh Institute of Bank Management (BIBM)
Mirpur-2, Dhaka

Questionnaire for the Study on
"Relevance of Correspondent Banking and Sanctions for Money Laundering"
(To be Filled by International Banking Wing/Division/Unit)

Name of the Respondent:	
Designation of the Respondent:	
Bank Address:	
Cell:	Tel :
Email:	

Correspondent Banking

1. How many correspondent banks does your bank have for cross-border transactions up to 2023?
    - Number of Correspondent Banks:
    - List/Name of the Banks:
    - Geographic Location of the Correspondent Banks:

2. How does your bank, as a respondent bank, select (Step by Step Process) a correspondent bank for cross-border transactions?
    - Approval Process from your own bank:
    - Documents Required:

3. While maintaining and establishing a correspondent banking relationship, what kinds of guidelines does your bank follow? [**You may select more than one**]
    - ☐ Own Bank Internal Policy:
        - Optional
        - Mandatory
    - ☐ BFIU Guidelines:
        - Optional
        - Mandatory
    - ☐ FATF Guidance Notes:
        - Optional
        - Mandatory
    - ☐ Correspondent Bank Guidelines:
        - Optional
        - Mandatory
4. What are the compliance requirements (due diligence) to maintain a correspondent banking relationship?
    - ☐
5. What types of services do you obtain from correspondent banks?
    - ☐
6. Does your correspondent bank obtain any service from your bank?
    - ☐ Yes, if yes, mention the services you provide to your correspondent bank
    - ☐ No

Correspondent Banking and Transaction Monitoring of Banks and Clients

7. How does your correspondent bank monitor (measure) your clients cross-border transactions to identify suspicious transactions?

- ☐

8. How does your correspondent bank monitor your bank's cross-border transactions to identify suspicious transactions?

- ☐

9. Does your bank have any connection with a shell bank?

- ☐ Yes
- ☐ No

10. What precautionary measures does your bank undertake to avoid shell banks?

- ☐

11. Is there any instance of termination of the Correspondent Banking relationship by your correspondent banks?

- ☐ Yes, mention the banks' name and reasons for termination
- ☐ No

12. Did your bank willingly close any correspondent banking relationship with foreign correspondent banks?

- ☐ Yes, mention the name of the banks and the reasons
- ☐ No

13. Mention the severity of the impact on the banker-customer relationship due to the termination of the correspondent banking relation.

	Significant	**Moderately significant**	**Insignificant**	**No Impact**
Banker-Customer relationship				
How does it affect your bank?				

Capacity Development for Compliance Requirements in Correspondent Banking Relationship

14. Please fill up the following box relating to Capacity Development for Compliance Requirements in Correspondent Banking Relationship

	Please Elaborate
a) Does your bank conduct training for the employees of the bank for capacity development to handle the compliance requirements of correspondent banks?	☐ Yes ☐ No, please mention the reason
b) What was the duration of the training course?	
c) What was the frequency of the training?	
d) Mention the key contents of the training course	☐
e) What was the date of the last training program held on compliance relating to correspondent banking?	

15. What risks or challenges does your bank face while maintaining correspondent banking relationships?

☐

16. What kind of measures do you expect for better transaction monitoring with correspondent banks?

Policy Measures from Regulators	
Bank Management Measures from Board and Management of Banks	

Implementation Status of Sanctions A. Sanction Screening [Name screening]

17. Does your bank have any sanction policy?

- ☐ Yes
- ☐ No

18. Does your bank have a sanction screening mechanism?

- ☐ Yes
- ☐ No

19. Has any transaction in your bank been blocked by OFAC/FINCEN or any other regulatory authority in the last five years? If yes, how much has been blocked in total?

- ☐ USD
- ☐ BDT

20. What measures have been undertaken by your bank to unblock this blocked fund?

- ☐

21. How often does your software/solution provider update the Sanction List?

- ☐

22. At what frequency does your bank perform sanction screening of non-transactional accounts?

- ☐

23. How is your bank implementing the following sanctions?

Nature of sanctions	Implementation Mechanism or Measures
UN	
US/OFAC	
EU	
UK	

24. What challenges is your bank facing while implementing the above sanctions?

25. Fill up the following box about the impact (cost/outcome) while implementing the above sanctions.

The Severity of Impact Due to Sanctions					
Nature of Impact	Significant	Moderately significant	Insignificant	No Impact	Please comment
Cost of operations on banks					
Banker customer relation					
Compliance requirements					
Banks' profitability					
Overall business of banks and clients					

26. What kind of regulatory measures and bank management measures do you expect to overcome the challenges or risks to implement different kinds of sanctions?

Regulatory measures: Measures (Policy Support) from the board and top management of banks:

27. Do you think that the implementing tools for handling different sanctions are effective?

- ☐ Yes
- ☐ No, please mention the reasons

B. Vessel Tracking

28. Does your bank have any vessel tracking policy?

- ☐ Yes
- ☐ No

29. Does your bank have any vessel tracking solution?

- ☐ Yes [Please mention the name]
- ☐ No

30. What are the major challenges of Vessel Tracking?

- ☐

31. What kind of regulatory measures and bank management measures do you expect to overcome the challenges or risks for the effective use of vessel tracking?

Capacity Development for Compliance Requirements in Sanctions [Name screening and Vessel Tracking]

32. Fill up the following box which is relating to the capacity development of employees in handling sanctions.

Capacity development on the tools to implement sanctions	
a) Does your bank conduct training on handling sanctions?	☐ Yes ☐ No, mention the reason
b) What was the duration of the training course?	
c) What was the frequency of the training?	
d) Mention the key contents of the training course?	
e) What was the date of the last training program held on sanctions?	

33. Fill up the following box which is relating to the capacity development of employees in handling Vessel Tracking.

Capacity development on the tools to implement a vessel tracking system	
a) Does your bank conduct training on handling vessel tracking?	□ Yes □ No, mention the reason
b) What was the duration of the training course?	
c) What was the frequency of the training?	
d) Mention the key contents of the training course.	
e) What was the date of the last training program held on vessel tracking?	

Appendix 2: List of Respondent Banks

Serial No.	Name of the Banks
1	AB Bank Limited
2	Agrani Bank Limited
3	Bangladesh Development Bank Limited
4	Bangladesh Krishi Bank
5	Bank Al-Falah Limited
6	Bank Asia Limited
7	Bengal Commercial Bank Limited
8	BRAC Bank Limited
9	Commercial Bank of Ceylon PLC
10	Community Bank Bangladesh Limited
11	Dhaka Bank Limited
12	Dutch-Bangla Bank Limited
13	Eastern Bank Limited
14	EXIM Bank Limited
15	ICB Islamic Bank Limited
16	IFIC Bank PLC
17	Islami Bank Bangladesh Limited
18	Jamuna Bank Limited
19	Meghna Bank Limited
20	Midland Bank Limited
21	Modhumoti Bank Limited
22	Mutual Trust Bank Limited
23	National Bank Limited
24	National Credit & Commerce Bank Limited
25	NRB Bank Limited
26	One Bank Limited
27	Pubali Bank Limited
28	Shahjalal Islami Bank Limited
29	Shimanto Bank Limited
30	Social Islami Bank Limited
31	South-Bangla Agriculture and Commerce Bank Limited
32	Southeast Bank Limited

33	Standard Bank Limited
34	Standard Chartered Bank
35	State Bank of India
36	The City Bank Limited
37	The Hongkong and Shanghai Banking Corporation Limited
38	The Premier Bank Limited
39	Trust Bank Limited
40	Union Bank Limited
41	United Commercial Bank PLC
42	Uttara Bank Limited

Appendix 3: List of Participants in FGD from Banks

Sl no.	Participant's Name	Name of the Bank
1	MD. Nasir Uddin	Southeast Bank Limited
2	Sayed M Abdullahel Quafi	Dutch Bangla Bank Limited
3	Mafizur Rahman Talukder	Basic Bank Limited
4	Khandakar Abul Hasnat	Basic Bank Limited
5	Shamima Nargis	Social Islami Bank Limited
6	Mohammed Sharif Uddin Ahmed	Mutual Trust Bank Limited
7	Ms. Tania Sultana	Eastern Bank Limited
8	M. Abul Kalam Azad	Dutch Bangla Bank Limited
9	Md. Rafiqul Islam	Islami Bank Bangladesh Limited
10	K. M. Alamgir Kabir	Eastern Bank Limited
11	F M A Rahim	Bangladesh Krishi Bank Limited
12	Syeedur Rahman	United Commercial Bank Limited
13	Muhammad Zahirul Islam	Dutch Bangla Bank Limited
14	Rashadul Karim	Padma Bank Limited
15	Taher Ahmed Chowdhury	Islami Bank Bangladesh Limited
16	Md. Rejaul Islam	Islami Bank Bangladesh Limited
17	Mr. Khan M Ahad	NBP, Bangladesh
18	Mr. Ataur Rohoman Joardder	NBP, Bangladesh

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It gives us immense pleasure to be affiliated with the Bangladesh Institute of Bank Management (BIBM) for publishing a keynote paper of its roundtable discussion. We believe that the new generation of bankers would get access to a pool of knowledge on key functional areas of the banking industry.

We believe that the book will not only empower the professionals with a better understanding of finance but will also broaden their capabilities and help them contribute more to the country's economic prospects.

Our best wishes to BIBM.

Selim R.F. Hussain
Managing Director & CEO
BRAC Bank Limited

BRAC BANK

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