SWIFT Response to European Banking Authority's request for input on 'de-risking' and its impact on access to financial services

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Confidentiality: Public

SWIFT thanks the European Banking Authority for the opportunity to provide comments on the call for input on 'de-risking' and its impact on access to financial services.

SWIFT is a member-owned cooperative headquartered in Belgium. SWIFT is organised under Belgian law and is owned and controlled by its shareholders, comprising more than 2,400 financial institutions. We connect more than 11,000 institutions in more than 200 countries and territories. A fundamental tenet of SWIFT's governance is to continually reduce costs and eliminate risks and frictions from industry processes.

SWIFT provides banking, securities, and other regulated financial organisations, as well as corporates, with a comprehensive suite of messaging products and services. We support a range of financial functions, including payments, securities settlement, reporting, and treasury operations. SWIFT also has a proven track record of bringing the financial community together to work collaboratively, to shape market practice, define formal standards and debate issues of mutual interest.

If you wish to discuss any aspect of our response please do not hesitate to let us know.

Kind regards,
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Introduction
SWIFT understands that the EBA is looking for input to understand why financial institutions choose to de-risk instead of managing the risks associated with certain sectors or customers. We welcome the EBA's consideration and analysis of this area and how it ultimately impacts the public and private efforts in relation to mitigating the risks of money laundering and terrorist financing.

Based on SWIFT's role, our area of concern focusses on de-risking relating to cross-border payments and in particular the potential impacts on the cross-border payments landscape caused by the reduction of correspondent banking relationships. Although the number of correspondents does not necessarily reflect the health, strength, reach and span of cross-border payment messages across the SWIFT network, the decline in correspondent numbers does reflect that there have been major changes to the composition, role and type of correspondents on the network. In our response we consider first the changes that we have seen in the number of active correspondents, consider drivers for these changes, consider potential negative consequences that may result and present a few recommendations for regulators to take into consideration to address the issue. Moreover, we have added an Annex to show SWIFT's efforts to help our customers to mitigate these issues.

Decline in Active Correspondent Banks
Although the volume and value of cross-border payments continues to grow, based on analysis performed by the CPMI and FSB with data supplied by SWIFT, between 2011 and 2019 the number of active correspondent banks worldwide has fallen by about 21%. The pattern reflects a higher concentration in payment flows amongst a smaller number of institutions, with the effects more pronounced in higher income, developed economies. The impacts of this decline have been considered in the BIS Quarterly Review [1] and are also considered in the Stage 2 report to the G20

from the CPMI [2]. Such conclusions have led to the FSB's and others' efforts to address the decline [3] and these themes are also considered in more recent work by the FSB and CPMI [2]. The downward trend in the number of active correspondent banks is occurring in all regions with the exception of Central America. In particular, it should be noted that the decline in active correspondents in Europe between 2011 and 2019 is slightly greater than the average seen elsewhere, reflecting that Europe has been impacted more by these changes than other regions.

Drivers of De-Risking
The reasons for the decline in numbers of correspondents are not fully understood. Many changes are due to market forces, competition and consolidation, but it is also clear that compliance related de-risking is one factor associated with the change. In this context de-risking needs to be considered in two ways. Firstly, there is policy based de-risking where the compliance risk itself is outside of the risk appetite of an institution and hence leads to termination of the business relationship presenting the risk. Secondly, there is economic de-risking where the cost and complexity of maintaining the business relationship does not create sufficient business value for it to be viable. In both instances the de-risking is exacerbated by the increasing complexity associated with compliance and the increasing commercial pressure associated with cross-border payments.

In both cases, growing regulatory pressure and increasing commercial pressure combine to create de-risking. Regulatory complexity leads typically to institutions having to apply policies that are not sufficiently granular to mitigate perceived risk and this can mean that banks with common characteristics (e.g. those in higher risk jurisdictions or those operating in jurisdictions with weak AML/CFT supervisory and regulatory frameworks) may be routinely de-risked irrespective of the nature of their business or the quality of compliance solutions in place at those institutions. Similarly, as payment networks become more efficient and as business margins are reduced the economic pressure can lead to less profitable relationships being terminated. Cyber-related de-risking is an additional new dimension that banks are also now having to tackle.

Negative Consequences of De-Risking
We concur generally with the findings of the CPMI, FSB and others, and believe that where banks are retreating and choice is reduced, there is a danger that institutions and customers of institutions may resort to unproven or less well regulated payment channels. A diversified number of active correspondents that are well regulated provides competition and choice for institutions and consumers. Where such channels are not available there is a danger of movement from highly regulated banking sectors to less well regulated sectors or channels outside of the banking system entirely. This ultimately undermines international financial integrity, reduces competition and choice and increases risk. It also typically increases the use of aggregator channels where payments are aggregated in the cross-border leg and ultimate originator and beneficiary details may not be available to all institutions in the payment chain.

Recommendations

- SWIFT believes that further harmonisation of legal and regulatory requirements would reduce de-risking. SWIFT welcomes the European Commission's proposal to reinforce and develop the EU AML/CFT single rulebook and believes that it has the potential to improve consistency, reduce complexity, and remove material cost and regulatory risk that acts as a barrier to doing business.
- Moreover, the EU should consider seeking further alignment with international standards, especially with FATF's guidance on correspondent banking published in October 2016. The latter favoured a risk-based approach considering that not all correspondent banking

relationships carry the same level of AML/CFT risk and that enhanced due diligence measures have to be commensurate with the identified risk.

- SWIFT would like to underline the importance of capacity building, which has also been advocated by the G20 countries, the FSB and International Monetary Fund. This is an effective way to mitigate de-risking of international correspondent banking relationships by helping governments improve their AML/CFT legal and regulatory frameworks, and related supervisory practices.
- SWIFT believes that there needs to be a level playing field across all payment channels such that disproportionate financial crime compliance costs associated with well-regulated channels do not themselves push institutions and customers to less regulated channels. Competition may also suffer if de-risking is not appropriately addressed. If there are only a relatively small number of service providers in a corridor or if some banks become reliant on a single relationship this may represent a risk to the resilience of correspondent banks and also create negative competition pressures.

ANNEX 1 - SWIFT's efforts in support of its Community

SWIFT's continues to support its community to reduce the impacts of de-risking by increasing the efficiency and certainty of payments and also providing compliance related tools and services to raise standards and reduce the cost of compliance.

Since 2012, SWIFT has provided a growing range of utility based compliance services to its community and we have over 5000 institutions using these services. SWIFT provides compliance services for sanctions, AML, KYC and fraud prevention. These services are all hosted by SWIFT and can be quickly and easily used by institutions, helping them to meet their compliance obligations. These services, in particular, help to support smaller institutions that are disproportionally effected by the costs associated with compliance. The services help to increase the effectiveness of institutional compliance and can assist in removing duplicated and unnecessary cost. The SWIFT KYC Registry, for example, helps institutions to streamline correspondent KYC checks, the AML tools allow a comprehensive assessment of AML risk, and the fraud and sanctions screening solutions allow smaller institutions in particular to defend against cyber-risk and comply in a straightforward way with sanctions regulations.

SWIFT launched the Customer Security Programme to help institutions address the growing threat of cyberattacks. SWIFT customers are individually responsible for the security of their own environments, however, the security of the industry as a whole is a shared responsibility. As an industry cooperative, SWIFT is committed to playing an important role in reinforcing and safeguarding the security of the wider ecosystem and also to reduce cyber-related de-risking. The Customer Security Programme (CSP) aims to improve information sharing throughout the community, enhance SWIFT-related tools for customers and provide a customer security control framework. Through the programme, we will also share best practices for fraud detection and enhance support by third party providers.

SWIFT also supports its community in terms of standards and market practice - both areas that help to reduce costs associated with compliance. The Payments Market Practice Group (PMPG), in collaboration with the Wolfsberg Group amongst others, has created initiatives that are helping to standardise payments practice, reduce risk, improve data quality and simplify compliance. SWIFT also believes that ISO20022 adoption will simplify compliance through improved data quality and stronger screening and compliance implementations.

SWIFT gpi has driven a major leap forward in cross-border payments, serving as a catalyst for unprecedented improvement in speed, transparency and predictability. Today, more than 65% of payments on SWIFT use gpi, representing more than $77 trillion in value last year alone. SWIFT gpi is helping to reduce the cost of payments and simplify. The new strategic ambition approved by our Board earlier this year, builds on this strong foundation to enable seamless, frictionless and instant payments from one account to another, anywhere in the world. It will help to address many of the de-risking challenges - from standards and compliance to rich data and lower cost – while maintaining robust resiliency, security and availability that are hallmarks of SWIFT.

[1] "On the global retreat of correspondent banks", BIS Quarterly Review, March 2020, https://www.bis.org/publ/qtrpdf/r_qt2003.pdf
[2] "Enhancing cross-border payments: building blocks of a global roadmap", CPMI, July 2020, https://www.bis.org/cpmi/pub/d193.pdf
[3] "FSB action plan to assess and address the decline in correspondent banking", FSB, Dec 2016, https://www.fsb.org/wp-content/uploads/FSB-action-plan-to-assess-and-address-the-decline-in-correspondent-banking.pdf