

Memorandum

An Update on Foreign Correspondent Banking

October 7, 2016

Correspondent banking is a service provided by U.S. banking organizations to foreign banks that do not have a U.S. banking subsidiary or branch. Without such a U.S. presence, a foreign bank must look to a correspondent banking relationship to clear its U.S. dollar transactions.

Foreign correspondent banking relationships have come under significant strain over the past decade, but particularly in recent years, as U.S. financial regulators and law enforcement agencies have more closely scrutinized these relationships and pursued enforcement actions with respect to anti-money laundering (“AML”) compliance. Increased enforcement risk and regulatory compliance burdens have led many banks to “de-risk” their foreign correspondent banking activities, sometimes terminating foreign correspondent accounts entirely from certain countries with unsatisfactory AML standards. In turn, account closures have led to “financial inclusion” concerns about the lack of access to critical financial services by certain categories of customers (including nonprofit organizations) in developing countries. In addition, in remarks today at the International Money Fund and World Bank Annual Meetings in Washington, D.C., U.S. Treasury Secretary Jack Lew recognized that “if the [AML compliance] burden is so high . . . that people withdraw from the financial system or are excluded from it, it ultimately raises the risk of illicit transactions.”

On October 5, 2016, the Office of the Comptroller of the Currency (“OCC”)—the primary federal banking regulator for national banks, federal savings associations, and federal branches and agencies (collectively, “banks”)—released guidance setting forth supervisory expectations for banks’ periodic risk reevaluations of their foreign correspondent account customer relationships. The OCC noted that, until this issuance, it had not issued specific guidance on this topic.

As part of its guidance, the OCC identified the following “best practices” that banks should consider when deciding to retain or terminate foreign correspondent banking relationships:

- Establish and maintain an effective governance function to review the method for risk reevaluation and to monitor the appropriateness of recommendations regarding foreign correspondent account retention or termination.
- Communicate foreign correspondent account termination decisions regularly to senior management.
- Communicate with foreign financial institutions, consider specific mitigating information these institutions may provide, and provide sufficient time to establish alternative banking relationships before terminating accounts, unless doing so would be contrary to law or pose an additional risk to the bank, national security, or reveal law enforcement activity.
- Ensure a clear audit trail of the reasons and method used for account closure.

The OCC reiterated that decisions whether to retain or terminate banking relationships reside with the bank. In doing so, the OCC sought to clarify that it does not direct banks to terminate entire categories of customer accounts without regard to the risks presented by the particular customer or the bank's ability to manage the risk.

The OCC's guidance follows a recent move by regulators to "dispel certain myths" relating to correspondent banking relationships. On August 30, 2016, the OCC and the other federal banking agencies, as well as the U.S. Department of the Treasury, issued guidance—styled as a "joint fact sheet"—summarizing key aspects of federal supervisory and enforcement strategy and practices in the area of correspondent banking. They explicitly stated that they do not have a "zero tolerance" policy that requires the "strict imposition of formal enforcement action regardless of the facts and circumstances of the situation." Rather, they noted that approximately 95% of BSA/AML compliance deficiencies identified by the federal banking agencies and the Treasury Department (through its FinCEN and OFAC units) are resolved without the need for an enforcement action. Nevertheless, it is clear that banks' foreign correspondent banking relationships will continue to be an area of supervisory concern. The OCC's release of "best practices" for banks is just the latest example.

For more information regarding recent developments on foreign correspondent banking relationships, please contact any member of the Firm's Financial Institutions Group.

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