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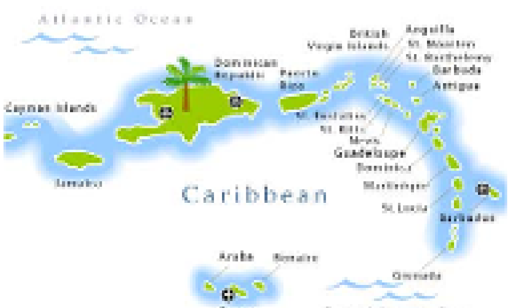
Wake Up and Smell the Non-Interest Income

HOW US BANKS CAN SOLVE A GLOBAL BANKING CRISIS

"BSA is a black hole of expenses"… "All of these BSA costs add nothing to our bank"… if you have ever heard (or uttered) these words it is time to take a new look at what BSA can add to your bank's bottom line. Small(er) banks in the US have some of the best operational AML experts in the form of their BSA Officers. The decision makers in these US banks should start leveraging their BSA Officer's talents to open up avenues of income by taking on higher risk products and customers. Which small US bank could use an extra hundred thousand dollars a year, or possibly more?

The following are the top 4 opportunities passed-over due to an abundance of *perceived* risk: 1) trade finance; 2) foreign correspondent banking; 3) marijuana related businesses; and 4) money service businesses. While these four areas do present increased ML/TF risk exposure, regulatory guidance has been provided for banks that are willing to take on



these riskier products or customers. Risk based approaches are essential, and not only to satisfy the regulators, but also to truly recognize the ML/TF risks and tailor intentional mitigants appropriately. One particular area, foreign correspondent banking (FCB), is in critical need of some smaller US banks to step in and add this product to their suite. Foreign respondents (non-US banks) that are customers of US correspondents (US banks) are being de-risked, their account relationships closed, and subsequently cut-off from the US banking system. As for the real reasons, only one can guess but it seems regulatory bodies are throwing up their hands saying they never told these US banks to exit relationships and US banks are pointing the fingers at the regulators saying they told them to exit the relationships. At this point, it does not matter whose fault it is. We have areas of the world, with contained risk exposure, that are at a 40%+ loss of foreign correspondent relationships. This means that these compliant foreign banks have no entry into the US financial market, when their business customers are dependent on transacting with US businesses. Specifically, the Caribbean market is hardest hit with over 60% loss of FCBs according to the IMF. Not only are we driving these legitimate funds into the underground market, but we are actually making our global fight against money laundering and terrorist financing that much harder. Not only can smaller US banks step in and close this gap, but by doing so, these US banks can take part of the non-interest income revenue stream that is an intrinsic advantage of a correspondent banking product.

Why Not?

Why are US banks hesitant to venture into the arena of higher risk products or customers? Why not embrace the riskier side when the risk factors can be controlled, identified, and mitigated… with the net risk exposure being a safe, even comfortable, level. Part of the answer, in speaking with community bank leadership, is fear of regulator criticism. My opinion is that the other part comes from fear of the unknown for bank leadership. For US community banks that have the manpower and some regulatory 'cushion' to pursue FCB, the case can easily be made by looking at a simple cost/benefit analysis. Non-interest income is most likely where the fees will go into… and let's face it, with most small banks this side of the house could use some sustainable income. In foreign correspondent relationships, the income stems from fees paid by the foreign bank for transactions on behalf of their customers. Some foreign correspondent relationships may be simple, requiring only wires and deposit accounts and others may be more in depth with the offering of letters of credit or foreign exchange services. The FFIEC's FinCEN Exam Manual describes additional services under the FCB umbrella (e.g. - nested accounts) that could exponentially increase the risk, and make it essentially unappealing for most US banks. According to Kem Warner of KAW Management Services Ltd, a leading AML expert in the Caribbean, most banks are not looking for high- risk services within their FCB relationship. They simply need access for Caribbean businesses to pay their suppliers and vendors in the US. Most 'available' banks in the Caribbean are looking for simple wire services, deposit services and in limited cases, letters of credit or foreign exchange services.

So What's In It For My Bank?

Fee income can range from $50,000/year to upwards of $500,000/year, per foreign bank relationship. If your bank is new to this type of risk, start out with one relationship and after the growing pains have subsided, efficiencies are capitalized and regulators have given their approval, then add more relationships. Eventually, your bank will compare the efforts (cost) and income (benefits) of FCB with the drip-drop of income gained from dropping an interest rate a fraction of a point and FCB will be a no-brainer decision.

Regulations Give a Green Light

There is nothing illegal or 'too risky' that would prevent any US bank from offering a foreign correspondent product. US regulators have the same guidebook BSA Officers have – the FFIEC's FinCEN BSA/AML Exam Manual. There are over 17 pages in the Exam Manual that provide step-by-step guidance for identifying risk factors, implementing mitigating actions and audit guidelines. In addition to this US resource, global regulatory bodies, such as Wolfsberg and FATF, have published multiple resources to outline practical instructions for assessing and documenting risks associated with FCB.

FATF

Office of the Comptroller of the Currency
U.S. Department of the Treasury

the Wolfsberg Group

US banks interested in offering FCB can be selective in the area of the world they want to target. A critical need at this point is the Caribbean market and they are held to the same, if not higher standards, than US banks. (Yes, higher standards in some areas of AML/CTF.) Most Caribbean banks are under a country compliance regime that has long enforced FATF recommendations in the areas of KYC, CDD/EDD and PEP risk. According to Mr. Warner, the region's audit standards are the same as US standards with some areas experiencing overregulation due to the standards required by some tier 1 US correspondent banks.

With an abundance of opportunity and limited risk exposure, why is FCB seen as something only the big banks can handle?

Resources for Long-Term Success

There are supplementary resources that further bolster the proper risk management of FCB. Training of all personnel associated with FCB is essential to not just meet a requirement, but to also ensure that the long-standing compliant nature of the product is upheld. The most comprehensive training solution on the market today is from ManchesterCF. Designed by former bankers and AML experts, their Correspondent Banking training solution will effect tangible change in a bank's day-to-day handling of FCB risk. Another resource that is available to both US and respondent sides are systems that allow US banks to 'know your customer's customer'. A cutting-edge solution currently available is Global Risk and Data Authority (GRADA) based out of the Cayman Islands. This platform allows for both sides of the correspondent relationship to manage and view risks real-time.

Next Steps

Will it take work? Absolutely! FCB is not a plug-and-play program. Risk assessments are essential, with the mindset that the ultimate goal is not to show "0" or "low" risk in all areas. A risk-based approach, according to Mr. Warner, will satisfy FATF requirements and provide opportunities to both US and Caribbean banks. The biggest drain of resources when starting an FCB program comes from the digestion of global regulatory guidance, extraction of the various risk factors, operationalization of those risk factors, and design of FCB risk assessments. Fortunately, most of this heavy lifting has been done if your bank is genuinely interested in providing foreign correspondent banking. *(not a sales pitch... free FCB program templates for US banks interested in correspondent banking)*

If your bank is interested in stepping into this new long- term revenue stream that FCB offers – evaluation of these areas are required:

- Review and assess your bank's appetite for this additional risk exposure
- Assess your BSA staffing levels and skills
- Review recent audit reports (looking for indicators that regulators see unidentified areas of risk)
- Perform cost v. benefit analysis
- Connect with Respondent Banks*

Please email **Sarah@PalmeraConsulting.com for a list of Caribbean respondent banks interested in US correspondent relationships .*

Palmera Banking Solutions is an AML/Sanctions compliance consulting firm offering expert solutions for long-term effectiveness and operational efficiency.