

Big Bank De-Risking

The invisible threat to
financial inclusion

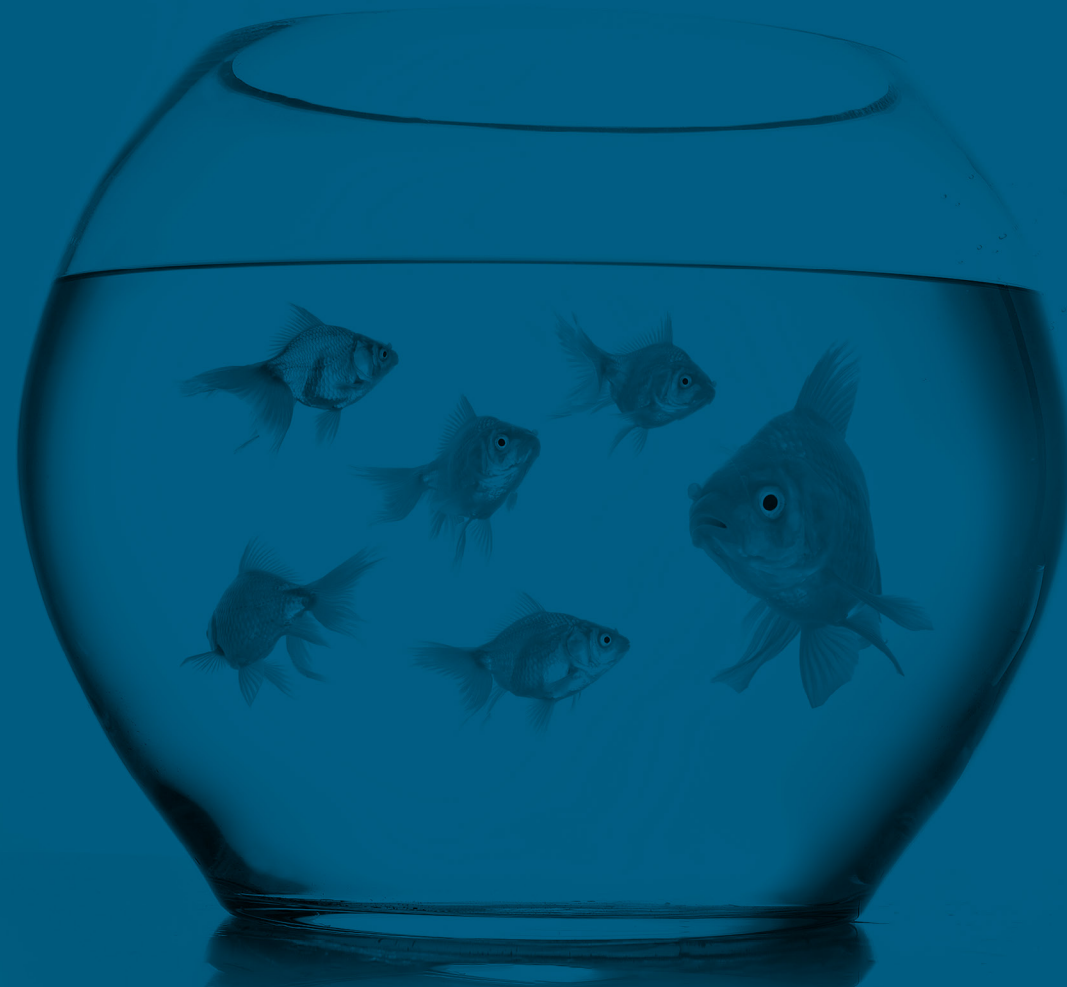


**BANKING
CIRCLE**

THE PAYMENTS BANK
FOR THE NEW ECONOMY

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INTRODUCTION

Bank de-risking is not a new phenomenon. It is not one of the multitude of changes we have seen in the wake of COVID-19 sweeping the globe. It is also, unfortunately, not something that we can look back on as an issue that has been left in the past.

Big banks have been protecting themselves from risk for generations; withdrawing from entire markets and geographies and using strict rule-based assessments to decline potentially high-risk applications. This practice is creating fundamental threats for smaller banks as well as Non-Bank Financial Institutions (NBFIs), and could have global and societal implications for generations to come.

Our latest research looks at how bank de-risking strategies across Europe are affecting smaller Financial Institutions (FIs), including banks and NBFIs. It also investigates how well the current correspondent banking offering serves these firms, and how the existing offering, coupled with de-risking, is compounding financial exclusion for many of their customers.

While de-risking may be nothing new, its impact is growing, and the industry must come together to reverse this change and increase financial inclusion.

Mitch Trehan

UK Head of Compliance and Money Laundering Reporting Officer,
Banking Circle



EXECUTIVE SUMMARY

In September 2021, Banking Circle launched its latest research project, seeking to identify the operational, customer experience and revenue/profitability threats facing smaller (tier 2 and 3) banks and NBFIs due to the de-risking strategies being implemented by top tier banks. This white paper highlights the global societal and economic risk of financial exclusion brought about by lack of access to cross-border payment and banking solutions, following such de-risking.



According to 77% of respondents to our study, the number of correspondent banking partners with which their organisation works has risen over the past ten years. This is likely to be a reaction to the de-risking trend, as they are forced to spread their own risk by working with a greater number of banks. More relationships mean more internal resources are required to manage the banking partnerships, and costs are incurred for each relationship, in-turn, increasing the cost to customers and depleting profitability. 65% of respondents feel they have too many banking relationships.

These higher costs and resource requirements are unsustainable for many smaller FIs and their customers. This is leading to individuals and businesses becoming financially excluded to a greater degree than ever before. However, the other looming threat for smaller businesses is the possibility of their bank withdrawing from the relationship altogether. Many respondents who were let go – de-risked – by their bank received very little notice, leaving them at risk of being unable to secure an alternative provider before the relationship ended. 44% of those de-risked by

their bank found themselves unable to offer international payments, 39% saw costs rise and 28% reduced the number of currencies they offer to their customers. Removing access to affordable cross-border payments increases financial exclusion for more vulnerable businesses and their customers. With the high cost of traditional cross-border payments, and the risk of being de-risked by their correspondent bank, smaller banks and NBFIs urgently need a new solution for their customers. 71% believe an alternative solution would bring global economic benefit.

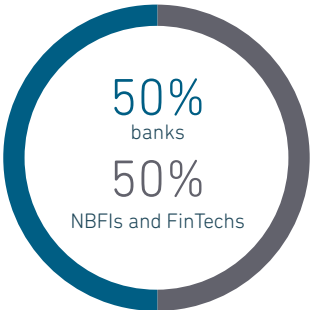
44% of those de-risked by their bank found themselves unable to offer international payments

RESEARCH METHODOLOGY

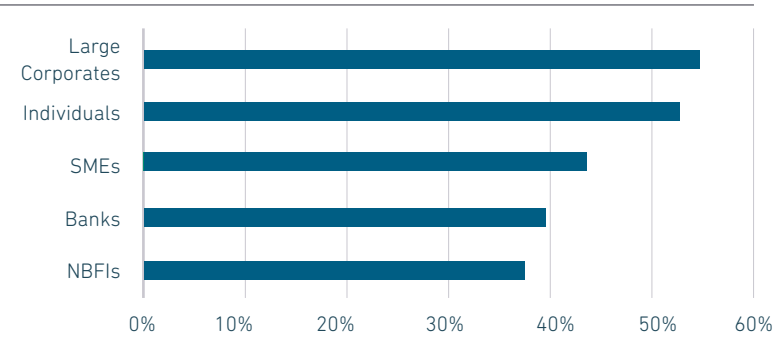
The market research was conducted online in September and October 2021, among a survey base comprising 700 Cash Managers and Corporate Treasurers of tier 2 and tier 3 banks, NBFIs and FinTechs serving businesses and individuals across Europe.

The 700 respondents were spread across the European regions involved:

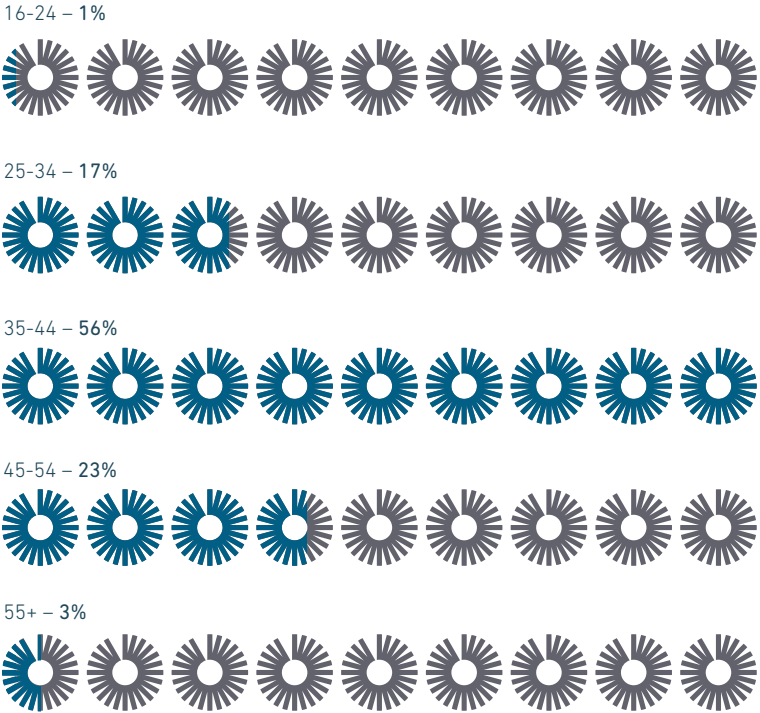
- 200 from northern Europe
UK/France/DACH/Benelux
- 100 from eastern Europe
Poland/Romania
- 200 from southern Europe
Spain/Italy
- 200 from the Nordic region
Norway/Denmark/
Sweden/Finland



Customers the respondents serve



Age breakdown of respondents



CHAPTER 1

THE HISTORY OF DE-RISKING

Banks have been executing de-risking strategies for decades, but the 2008 financial crisis brought about an irreversible shift that accelerated de-risking strategies around the world.

The political agenda and that of the regulators changed as a result of the financial crisis. Regulators began to see banks as more of a target than ever before and changed focus away from working alongside banks to combat financial crime. The current high level of bank de-risking activity began in 2012, when [HSBC had to pay US authorities](#) a \$1.9bn (£1.2bn) money laundering settlement. This unprecedented fine sparked the global de-risking movement that continues today, as banks were forced to de-risk or introduce measures to protect themselves.

To meet regulatory requirements, correspondent banks must individually assess the risk each client presents. Carrying out effective risk assessment is expensive, especially at the start of a relationship, and still uses largely manual processes at most correspondents. Of course, the high cost and time invested in setting up a potential new relationship is borne by the bank whether or not the prospective client is found to have satisfactory Anti-Money Laundering (AML) controls or presents a good or bad risk.

To reduce risk, many banks found it faster and easier to exit entire sectors and regions that sat beyond their new risk appetite, than to assess the risk consisting of thousands of individuals or smaller business customers. To protect themselves, smaller FIs, including banks and NBFIs, are being forced to exclude and de-risk their own underlying customers to meet their correspondent bank's risk appetite.

The drastic de-risking action by the big banks has left many smaller banks and NBFIs without correspondent banking partners. This has led to [financial exclusion](#) for many of their customers.

Drastic de-risking action left many smaller banks and NBFIs without correspondent banking partners



CHAPTER 1 – THE HISTORY OF DE-RISKING

The threat today

The past decade has seen this situation get worse for some. Today smaller banks and NBFIs are facing a fundamental threat to their operations that could have global societal and economic implications.

A [2016 report](#) from the International Finance Corporation (IFC), a member of the World Bank Group, explained that the “Anti-money laundering/ combating-the-financing-of-terrorism laws are grounded in reasonable national security concerns—preventing the cross-border flow of funds to terror or criminal groups,” but pointed out they can have “unintentional and costly consequences”.

A 2015 [study by the World Bank](#) found that 75% of large global banks were experiencing a decline in correspondent banking relationships (CBRs), and 80% of banks said they had “terminated all CBRs with financial institutions in certain jurisdictions.” 85% confirmed

that they had “restricted the size and/or scope of CBRs in certain jurisdictions.”

The following year, an International Chamber of Commerce (ICC) [Global Trade and Finance Survey](#) revealed that 41% of banks reported having “terminated correspondent relationships” due to the “increasing cost or complexity of compliance.”

[A report](#) from the Bank for International Settlements (BIS) showed the decline continued around the world: “The number of active correspondent banks worldwide fell by about 3% in 2019 and about 22% between 2011 and 2019.” [BIS agrees](#) that de-risking caused by the 2008 financial crisis is a key driver in this enduring trend: “An overarching theme is that in the aftermath of Great Financial Crisis, global banks have reassessed their business strategies against the backdrop of lower bank profitability, dampened risk appetite and tighter regulation and supervision.”

A [2021 report](#) from The Financial Action Task Force (FATF) on the unintentional consequences of de-risking stated that “profitability concerns are the primary driver [in de-risking policies]”, while other drivers include “fear of supervisory actions, reduced risk appetite in banks, and reputational concerns.”

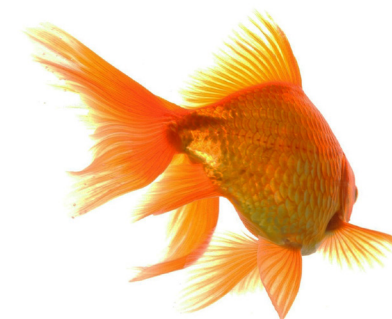
When the model works

In a perfect world, where every bank fully complied with AML and Combating the Financing of Terrorism (CFT) regulations, had good systems, and every regulator fully implemented FATF recommendations, correspondent banking would be a straightforward business. The problem is that we do not live in that world – not yet at least.

If a client sends the correspondent a high volume of business, the model still works, as there is enough business to cover the high cost of onboarding as well as the ongoing assessment and

monitoring costs for the duration of the correspondent relationship. However, if the client only sends a modest amount of business the assessment process is too expensive relative to the potential income, leading to an unprofitable relationship. Many correspondents politely decline to take on such relationships and exit their clients where the ongoing assessment costs outweigh the commercial returns.

Smaller banks and NBFIs, and those in regions with less demand for cross-border payments, often find themselves unable to access fair and affordable international banking solutions. This leads to already financially vulnerable societies and businesses being excluded further and put at a greater disadvantage than ever. It is a dangerous spiral that the financial industry has a moral responsibility to bring to an end. All individuals and businesses should have fair access to the banking solutions they need to prosper.



CHAPTER 2

RELATIONSHIP STATUS



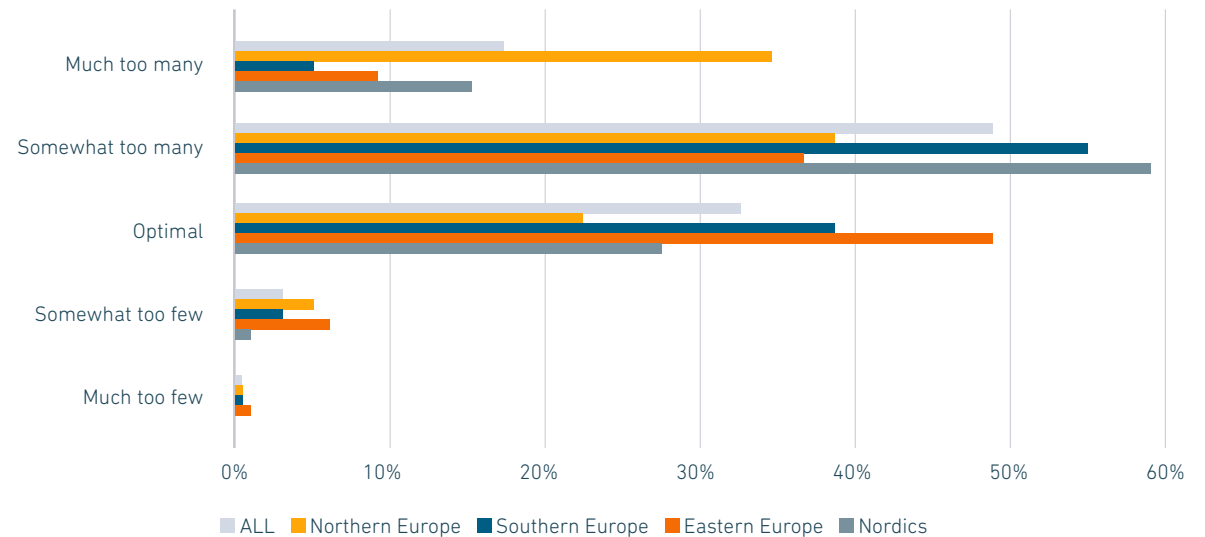
Despite the falling number of correspondent banks around the world, 77% of survey respondents reported that their organisation has increased its number of correspondent bank relationships in the last 10 years. Southern Europe was the region most likely to have seen an increase (87%), while northern Europe saw the greatest decline in relationships (14%). Only 1 in 3 feel they have the right number of relationships – most feel they have too many. The sentiment was the same across banks and NBFIs.

Most respondents reported having three or four correspondent banking relationships, with banks having more relationships than NBFIs and FinTechs. Respondents in the Nordics were most likely to have only one or two relationships and eastern European institutions are the most likely to have five or more.

Eastern European respondents have the highest number of relationships, have seen the biggest increase in the past decade and were the most satisfied with the number of banking relationships they have. Respondents in eastern Europe were also the most likely to feel they would benefit from more relationships.

All other regions reported having fewer relationships than eastern Europe and less of an increase, yet still feel they have too many.

Which of the following best describes the number of correspondent banking relationships you have?



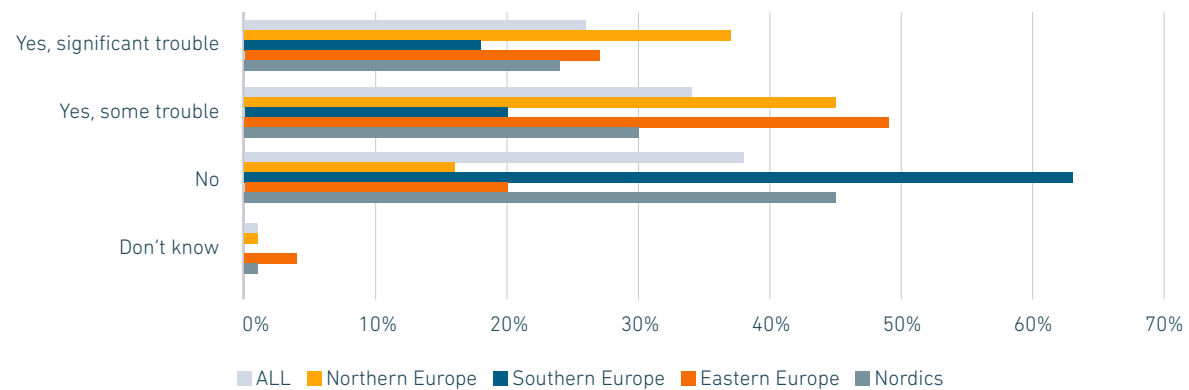
CHAPTER 2 – RELATIONSHIP STATUS

Changing relationships

2 in 3 of our respondents say their institution has had trouble obtaining correspondent banking partners in the last 10 years, and costs have increased for 80% in the same period.

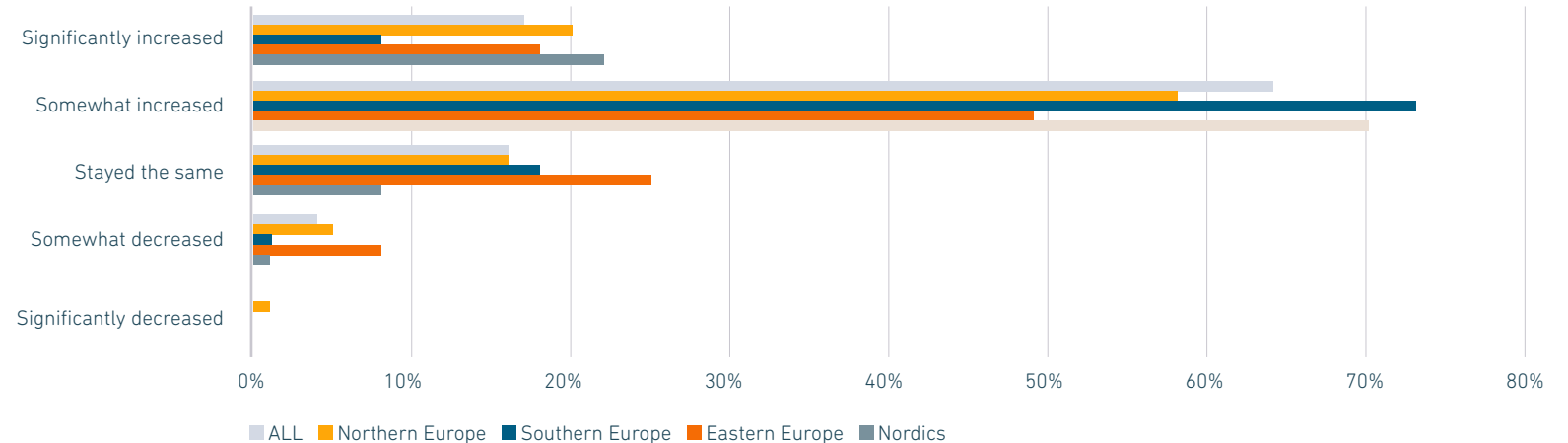
Respondents based in northern Europe struggled most, with 37% having significant trouble and only 16% having experienced no issues. Southern Europe found it easiest, with 63% having no trouble. FIs in the Nordics saw the greatest increase in costs, with 91% having seen an increase. Very few of those we spoke to saw costs fall in the past decade – eastern European institutions saw the biggest decrease, yet only 8% of respondents had seen costs decline.

Has your institution had trouble in obtaining correspondent banking partners to service your customer needs in the last 10 years?



Correspondent banking costs have increased for 80% of banks and NBFIs

To what extent have the costs from your institution's correspondent banking partners increased/decreased in the last 10 years?



CHAPTER 3

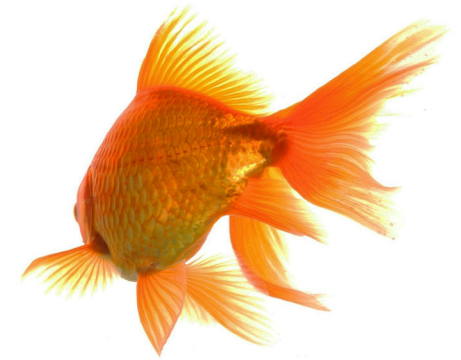
CAUSES AND IMPACTS OF CHANGE

In the past decade, most of the professionals we spoke to have increased the number of correspondent banking partners they work with. However, this is clearly not their first choice as most feel they have too many relationships – unsurprising given 80% say the cost of their banking relationships have increased.

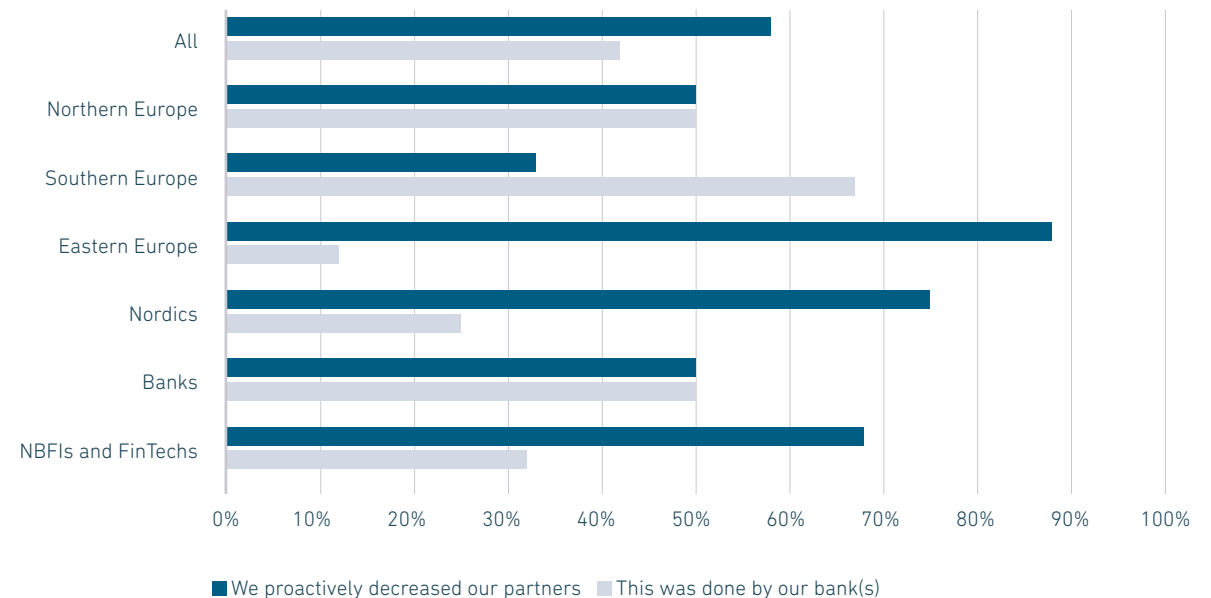
Instead, this increase is likely to be a reaction to the de-risking trend, in that they are protecting themselves from de-risking by spreading their own risk across multiple banking relationships.

Of those respondents who have seen the number of relationships decrease since 2011, 2 in 3 took the proactive decision to reduce numbers, while the remaining 1 in 3 found themselves dropped by their bank or banks. Respondents in southern Europe are the most likely to have fallen victim to bank de-risking, while eastern European respondents were the most likely to have taken the decision themselves. NBFIs were more likely than banks to have made the decision themselves.

Looking at the banks and NBFIs who proactively withdrew from banking relationships, we found that more than half (52%) did so to benefit from better pricing. Reducing the number of relationships meant their flow to each provider increased, gaining them access to better pricing. This driver was closely followed by now having access to more products and services through one bank, thereby reducing the need for multiple banking relationships (48%). A third (32%) said they reduced the number to make the remaining relationships easier to manage.



Did you proactively decrease the number of relationships or was this done by your bank(s)?
(Those whose correspondent bank relationships have decreased in the last 10 years)



CHAPTER 3 – CAUSES AND IMPACTS OF CHANGE

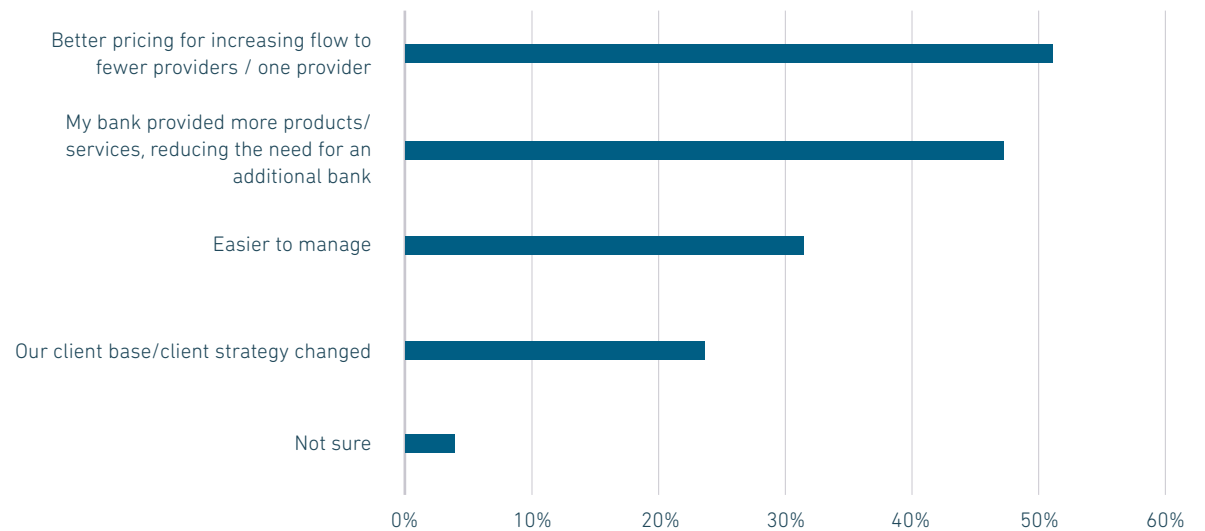
When banks walk away

When the relationship was ended by the bank, 2 in 3 of our respondents said the bank told them it was because they no longer met the bank's eligibility criteria. 39% of respondents were told their volume of flow was too low and did not generate enough income for the bank to continue to serve them. 1 in 3 found themselves dropped when the bank no longer offered the products they require, the regions they serve now fall outside of the bank's risk appetite, or due to a breach of AML/Know Your Customer (KYC) requirements.

Whatever the reasons behind the relationships ending, the falling number of relationships has led to 44% of respondents no longer offering international payments. 39% have seen costs increase and 22% lost clients as a result.

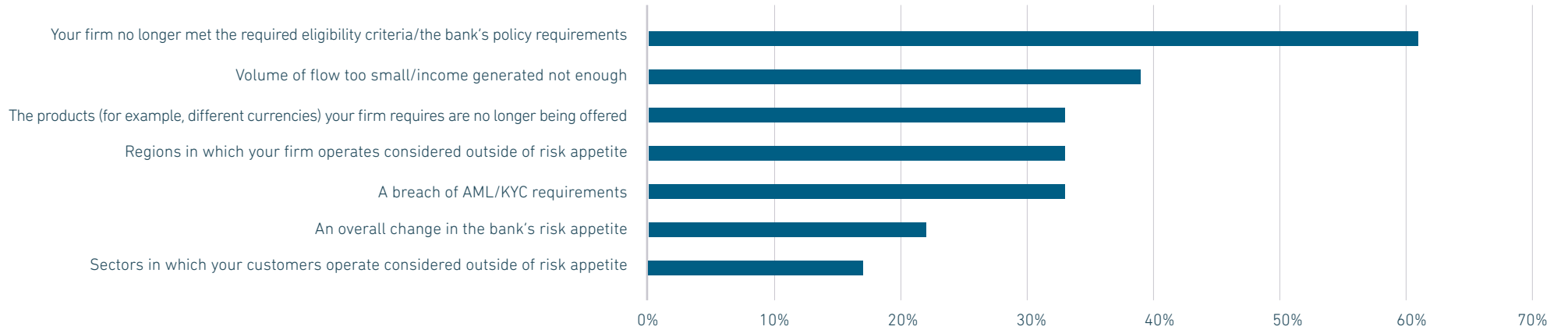
60% of respondents who have been de-risked by their bank were given less than two months' notice. Worryingly for these banks and NBFIs, the same proportion of all respondents have had trouble obtaining correspondent banking partners in the past ten years. The result can be lost customers, falling remittance volumes and a knock-on impact on profits.

If you proactively decreased the number of relationships, why did you do this? Tick all that apply
(Those who proactively decreased their correspondent bank relationships)

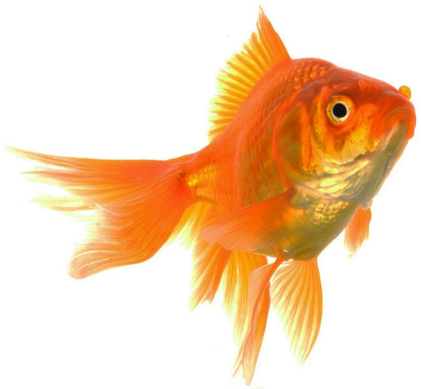
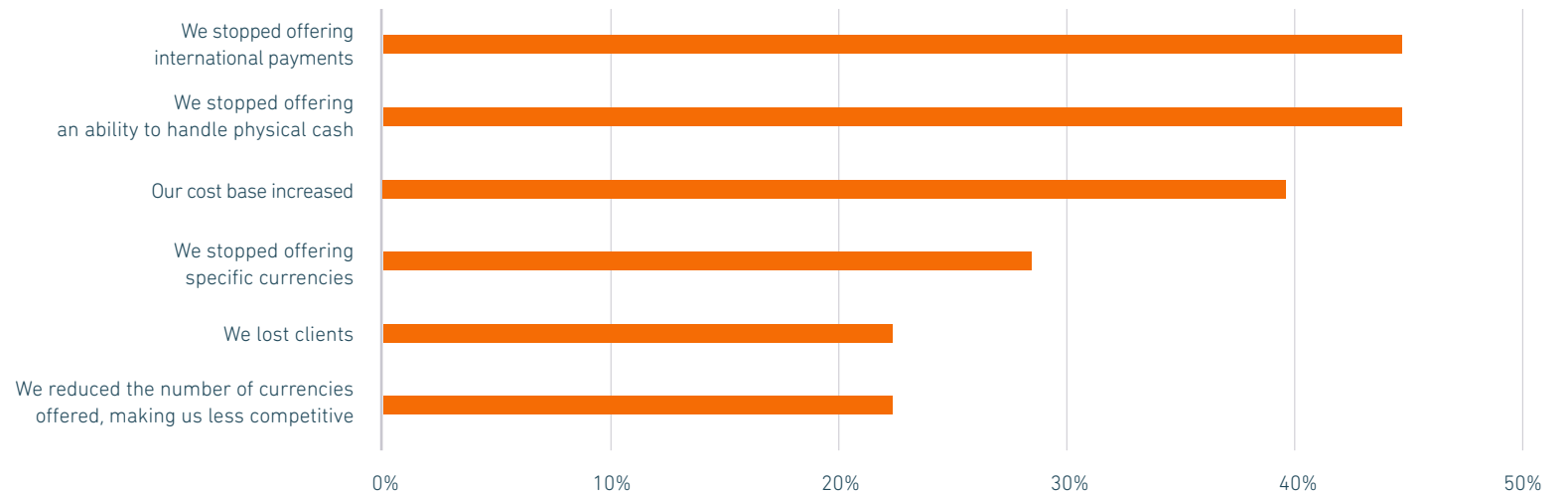


CHAPTER 3 – CAUSES AND IMPACTS OF CHANGE

If your bank ended the relationship, what reason(s), if any, did they give? Tick all that apply (Those whose correspondent bank relationship(s) was decreased by their bank(s))



If your bank ended the relationship, what impact, if any, did this have on your business? Tick all that apply (Those whose correspondent bank relationship(s) was decreased by their bank(s))



CHAPTER 4

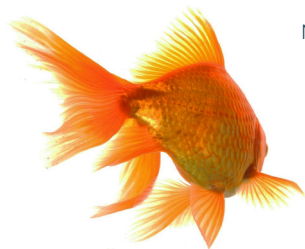
CORRESPONDENT BANKING OPTIONS



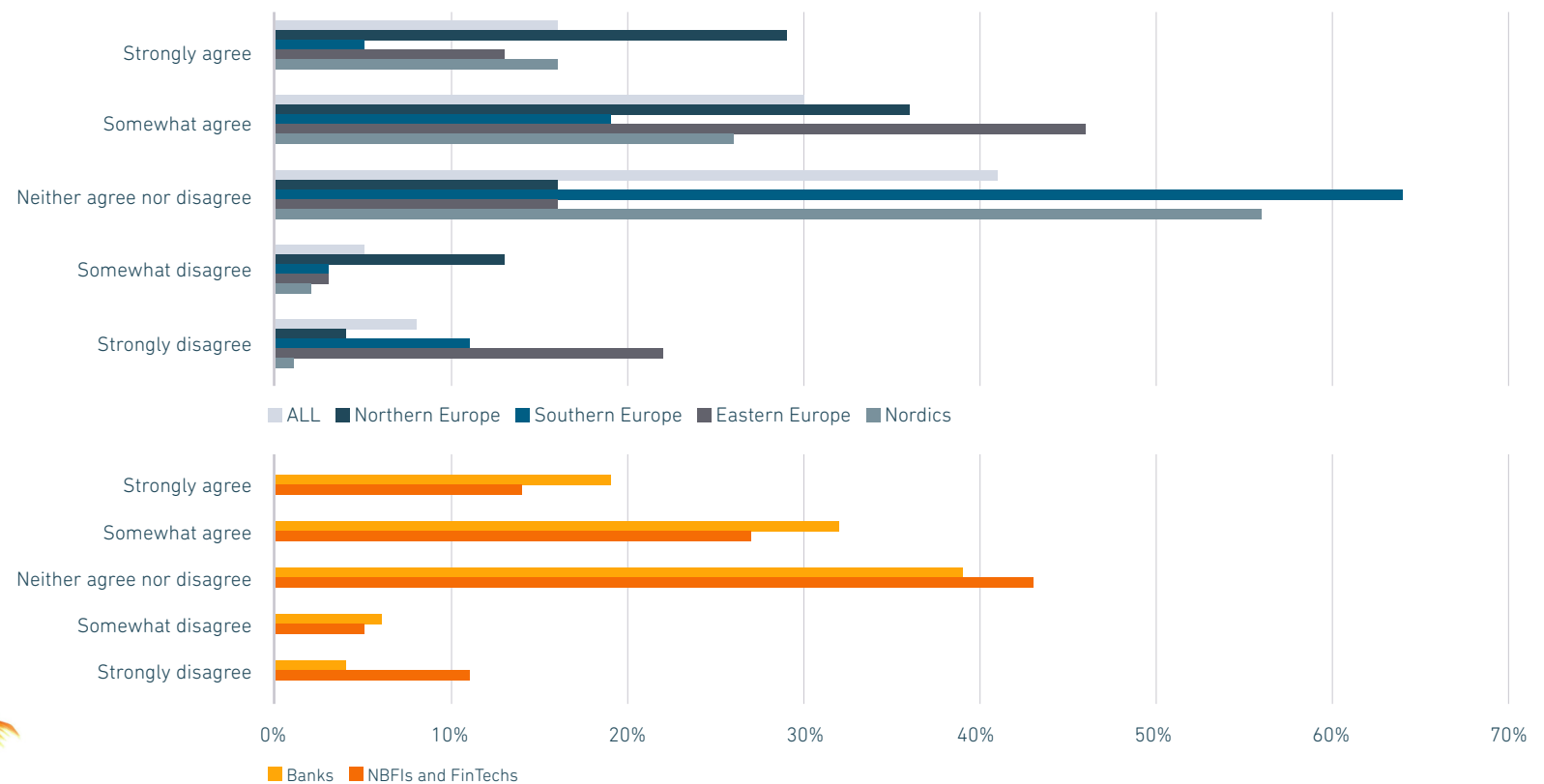
4 in 5 of the Cash Managers and Corporate Treasurers we spoke to have experienced increased correspondent banking costs in the past ten years. 3 in 4 believe they have lost customers due, at least in part, to a lack of access to fair priced correspondent banking partners.

Less than half of our respondents feel there are good alternatives to the traditional correspondent banking network that could help them avoid these increasing costs and the negative impact of the existing solution. 71% feel that the global economy would benefit from an alternative solution.

There is an interesting disparity in opinion between those operating in northern and southern Europe: 66% of those in northern Europe feel there are good alternatives to the traditional correspondent network, compared to just 24% of those in southern Europe.

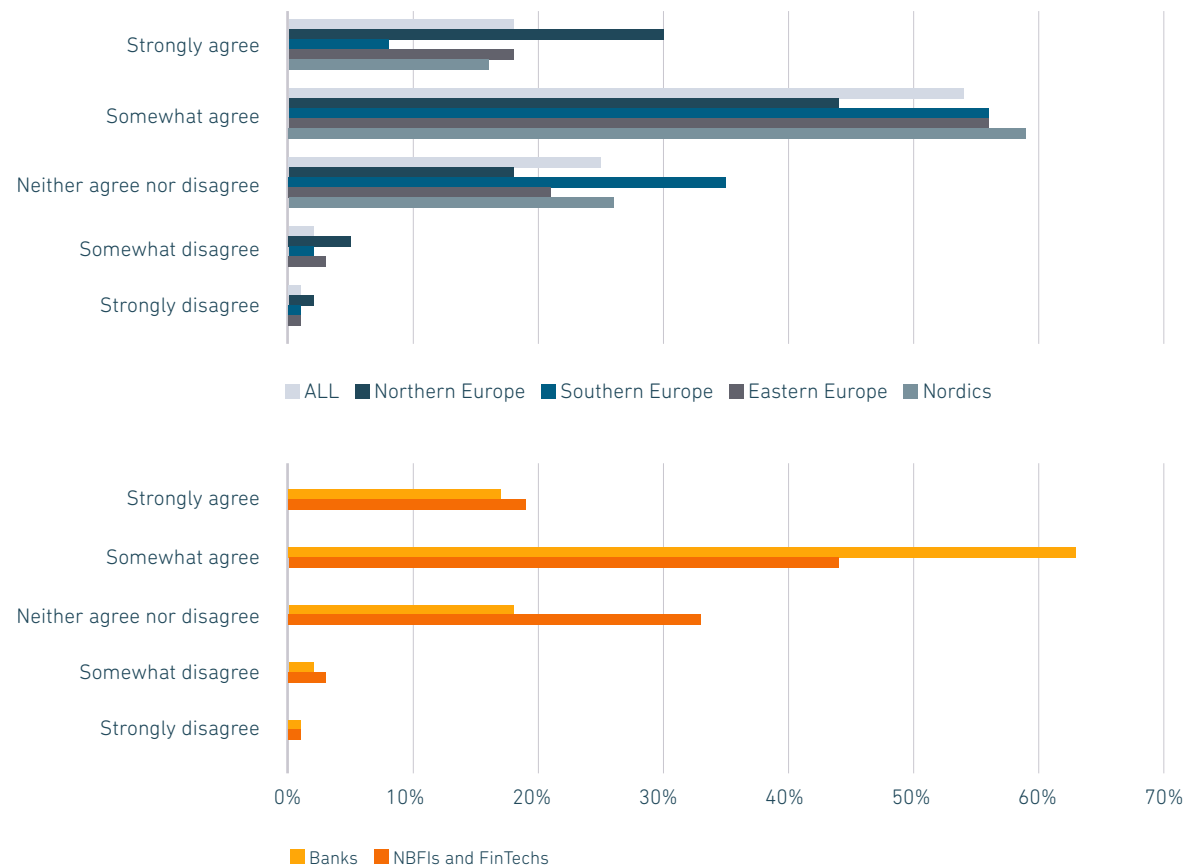


To what extent do you agree or disagree with the following statement? "I feel there are good alternatives to the correspondent banking network to send international payments for my customers"



CHAPTER 4 – ACCESSING BUSINESS FINANCING

To what extent do you agree or disagree with the following statement? "I think the global economy would benefit from an alternative to the current correspondent banking network"



Seeking an alternative

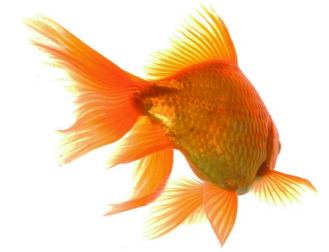
The reality is that not all banks provide a cross-border payment service, so there are few providers and little competition. In addition, continued de-risking strategies mean the number of providers is continuing to decline.

There is currently no true alternative to the traditional correspondent banking network. To gain access to cross-border payments, there must still be a bank at the top of the chain with direct access to clearing. Rather than an entirely new solution, correspondent banking services must change to become more accessible.

Encouragingly, a lot has been happening over the last few years that is smoothing the way for this change.

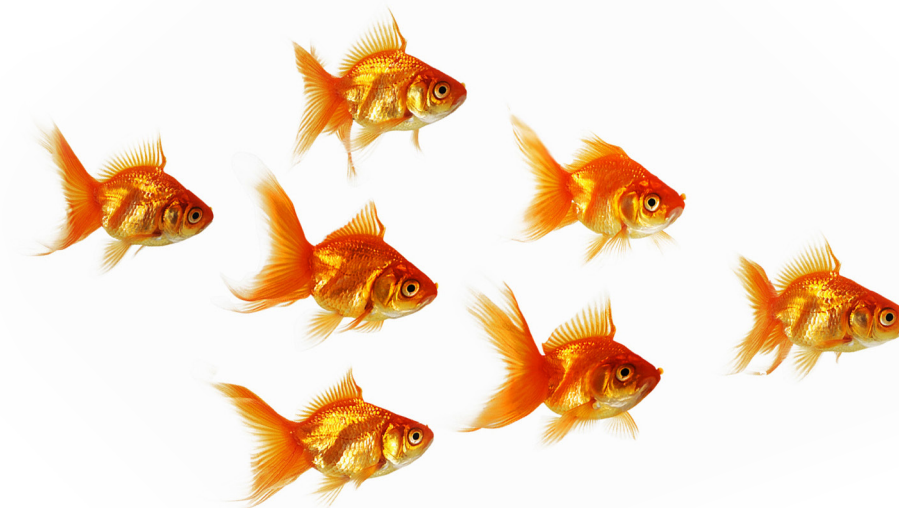
Those banks and NBFIs that need correspondent banking services have been investing in their compliance and AML regimes, rooting out financial crime and positioning themselves as more attractive prospective customers for the bigger correspondent banks.

In addition, correspondent banks themselves have been investing in better AML controls and systems, and a new type of correspondent bank has entered the market. Newer entrants like Banking Circle, a super-correspondent bank, have the privilege of developing systems and processes on a modern technology stack. Technology is deployed rapidly, constantly fine-tuned and enhanced to address emerging threats and deliver a more accessible solution that provides a new approach to correspondent banking.



CHAPTER 5

CONCLUSION - FINDING A SOLUTION



To find a solution to the de-risking dilemma it is important to understand the contributing factors. Regarding AML/CFT, 3 in 4 of our respondents said that their firm has had a third-party audit to confirm adequate controls are in place (78%) and that their correspondent banking partners have engaged their organisation on relevant training (72%). With these measures in place, risk and cost to the correspondent bank is significantly reduced, begging the question, why are smaller banks and NBFIs being de-risked at all?

A new approach, not a new solution

Banks cannot change their de-risking policies. After all, the regulations to which they must adhere are not going to change and they are required to protect all players in the market as well as their customers. But a lack of clear communication between FIs and their banks could well be a key issue. If these relationships

are managed better, with regular communication, then banks are more likely to understand why financial institutions are pursuing their particular business strategies.

In addition, smaller banks and NBFIs could utilise relationships with providers that truly understand businesses operating in today's digital economy. Those specialists should also be able

to access the data and artificial intelligence required to run robust AML screening which, in turn, will protect against risk without shunning entire regions or sectors.

When we asked our respondents whether they believe there are alternatives to the traditional correspondent banking network, we were surprised to see so many saying 'yes.' We were even more surprised to hear them list 'alternative' solutions that do in fact still rely on a traditional correspondent bank. That bank may be right at the top of the chain, several steps away and thus hidden from the FI's view, but it is still there and that will always be the case.

As we have explained in this white paper, the industry does not need to waste time and money seeking

an impossible alternative to this traditional solution. Instead, it must find a new approach to correspondent banking.

The new approach can use technology strategically, to improve processes and lower the costs involved with risk assessment and cross-border payments themselves. That is what we do at Banking Circle, and we think it is the way forward.

The Banking Circle approach

Developing new technology that more easily and accurately assesses risk and reduces costs has allowed us to smooth the way for even the smallest business to trade internationally. This is already increasing financial inclusion rather than excluding an increasing number of jurisdictions and market sectors.

Our organisation is cloud-based, with specifically designed internal processes and data capture points to easily provide accessible information to the right people. This means we have a well-honed, technology-enabled AML regime, and while it still has human oversight and governance, it presents our analysts and compliance personnel with high quality data with which to make prudent risk decisions. This enables us to be more efficient, and consequently, our cost-to-serve is far lower.

As a result, Banking Circle does not just tolerate working with smaller banks and NBFIs that may not be attractive to other correspondents – we actively seek them out as customers.



Banking Circle is a fully licenced next generation Payments Bank that is designed to meet the global banking and payments needs of Payments businesses, Banks and Marketplaces. Through our API, we deliver fast, low cost global payments and banking services by connecting to the world's clearing systems – enabling our clients to move liquidity in real-time for all major currencies securely and compliantly. Our solutions are powering the payments propositions of more than 200 regulated businesses, enabling them to gain the geographic reach and access to the markets in which their customers want to trade. We process over 6% of Europe's B2C e-commerce flows and in 2021 alone, we processed over 250 billion Euros in payments volumes.

www.bankingcircle.com